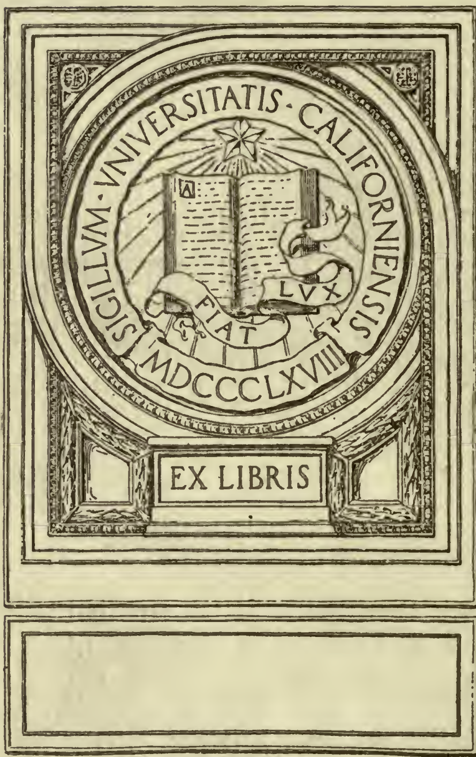
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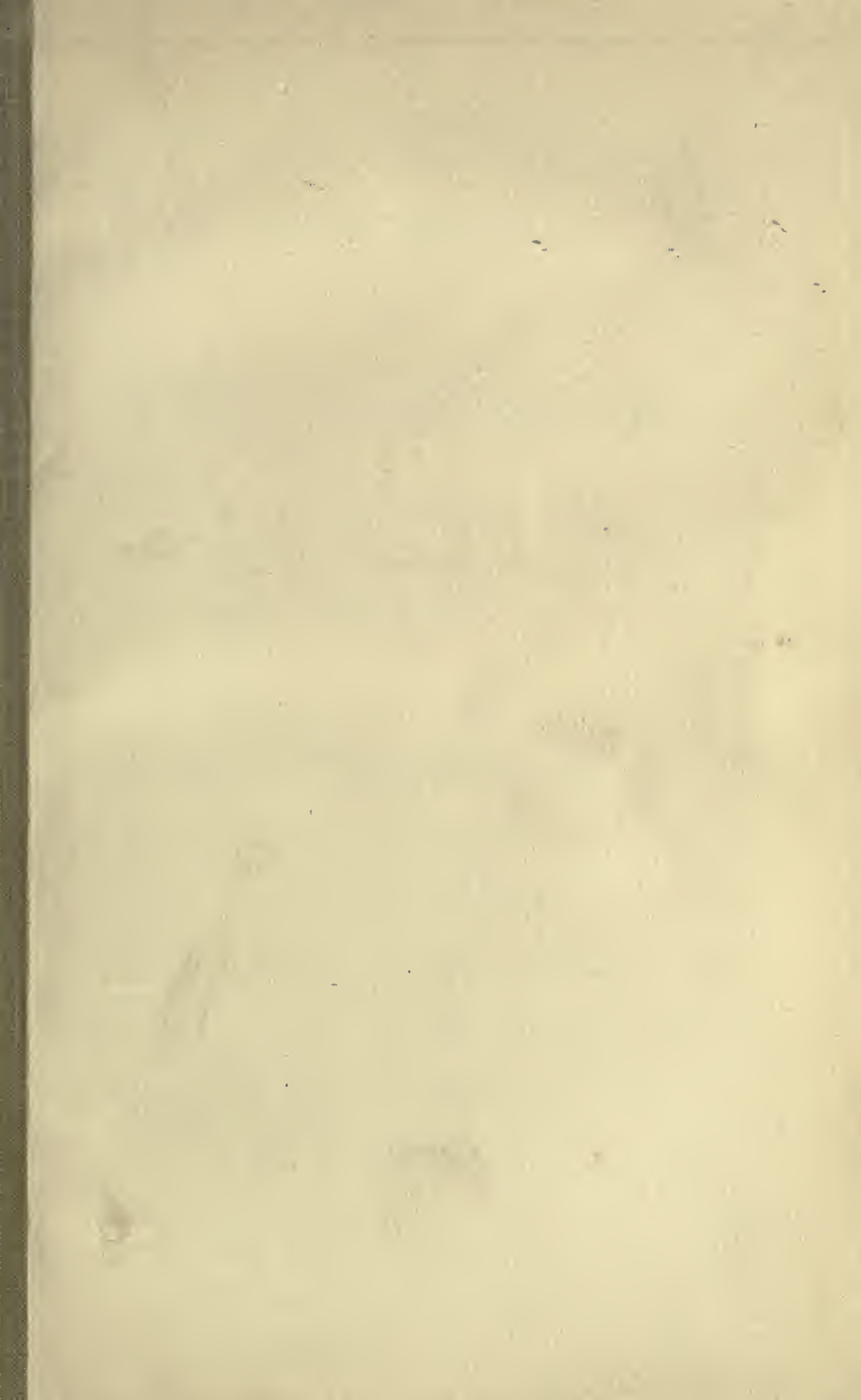

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THE

PRINCIPLES

OF

SURETY UNDERWRITING

with Annotations

Giving the Law of the Several States on

Important Points

BY

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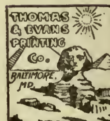

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PREFACE.

The need of a book dealing comprehensively with the problems of surety underwriting has long been felt by surety men; and since no one else seemed willing to undertake the task of supplying this need, I have made the attempt, and submit the result to the surety fraternity with the hope that it may be useful. I have tried to make it serve the two-fold purpose, first, of affording a convenient means whereby those who are unfamiliar with the business may learn the fundamental principles of underwriting, so that they may have the foundation upon which to comprehend, interpret and apply the underwriting policy of their respective companies, and, second, of affording a convenient reference book for the more experienced underwriters, so that they may refresh their memories on points or details that may be obscure, and obtain exact information as to the law of the several States on important points.

This is a broad subject and the information pertaining to it has never been put in available form; but fortunately I have not been compelled to rely entirely upon my own observation, experience and study, but have had the benefit of much of the statistics that have been gathered by the companies from their claim files and have had the privilege of consulting some of the foremost underwriters in the business; and I desire

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especially to acknowledge my indebtedness to E. K. Wilson, Esq., Attorney in Charge of the Legal Department of the American Bonding Company of Baltimore; Alexander Coulter, Esq., Manager of the Public Official and Depository Department of the Fidelity and Deposit Company of Maryland; Millard Leonard, Esq., Superintendent of the Judicial Department of the same company; and W. B. Wood, Esq., Engineer of the same company; and E. E. Kolb, Esq., Superintendent of the Fidelity Department of the Maryland Casualty Company.

LUTHER E. MACKALL.

New York, April 27, 1914.

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INTRODUCTION.

Concerning Personal Suretyship.

Personal suretyship, though one of the oldest institutions of the human race, has always been very unsatisfactory. It is unsatisfactory because, on the one hand, those who become sureties rarely receive any compensation for so doing, and nevertheless are often compelled to answer for a default of their principals; and, on the other, because the sureties are often found, upon default of their principals, to be insolvent, so that real protection is not afforded to those who are entitled to protection.

Origin and Growth of Corporate Suretyship.

It seems to have been about the middle of the last century when some enterprising individuals, whose names have not been handed down to posterity, realizing the disadvantages of personal suretyship, conceived the idea of forming a corporation for the purpose of going into the business of becoming surety on bonds and charging a fee for the service; for in the year 1865 the Legislature of the State of New York, by Chapter 328 of the Acts of that year, authorized the formation of corporations to guarantee the fidelity of persons holding places of public or private trust. No doubt some people were at that time desirous of forming a corporation for that purpose; and it may be that such a company was actually formed. But the first American company that ever actually transacted the business of suretyship in this country was the Fidelity and Casualty Company of New York, which was incorporated in 1876 and began business in 1879. The business of this company, like that of the Guarantee Company of North America, an earlier Canadian corporation, did not at first extend

beyond the guaranteeing of the fidelity of persons in positions of private trust, as the law did not then authorize the acceptance of such companies as surety on bond required by law to be given. However, in the year 1881 the Legislature of New York, by Chapter 486 of the Acts of that year, authorized any head of department, surrogate, judge, sheriff, district attorney or any other officer who was required to approve the sufficiency of any bond, in his discretion, to accept the same whenever the conditions of such bond were guaranteed by a company authorized to guarantee the fidelity of persons holding positions of public or private trust.

In 1884 the American Surety Company of New York was formed, and that Company issued bonds to guarantee the fidelity not only of private employees, but also of executors, administrators, guardians, trustees and other fiduciaries. In 1890 the Fidelity and Deposit Company of Maryland was formed, and that company still further broadened the scope of the business to include bonds of public officers. In the next few years, in view of the very successful operation of the American Surety Company of New York and the Fidelity and Deposit Company of Maryland, half a dozen other companies were formed, and now there are actively operating throughout this country about twenty-five companies with an aggregate premium income of something like $25,000,000 annually.

American surety companies are operating not only in every state, county, city and village in the United States, but also in several foreign countries, including England, the principal European countries, South America, Cuba, Porto Rico and the Philippines. In all

the States the law has been so changed as to permit the acceptance of duly accredited surety companies as sole surety on all bonds required by law to be given, and the corporate surety is rapidly taking the place formerly occupied by the personal surety.

The Nature of Suretyship.

Suretyship presupposes the existence of a primary obligation; and the undertaking of the surety is that the primary obligor, or principal, will perform that obligation. The undertaking is usually in the form of a bond of both the principal and surety for the payment of a definite sum of money upon condition that if the principal shall perform the obligation, the bond shall be void. However, in case of default the bond will be satisfied by the payment of the resulting monetary damage, not exceeding in any event the amount of the bond; and the principal is bound, to the extent of his resources, to pay that damage or to reimburse the surety in case the surety should pay it. It is however, the practice of surety companies to require all applicants to execute an express undertaking to indemnify the surety not only against loss but also against all costs, expenses and counsel fees.

Contrasted with Insurance.

Suretyship is like insurance (other than life insurance), in that its purpose is to indemnify against loss upon the happening of an uncertain contingency, namely, the default of the principal. The underlying theory of the business of suretyship is however different from that of insurance. An insurance company, though formed for profit, is essentially a medium through which a large number of persons co-operate together and pay in a certain sum periodically to take care of all their

losses from the happening of a named contingency,—the theory being that a certain average of losses is bound to occur, and that those losses, if borne by the few upon whom they fall, may ruin them, but if distributed among a large number, will work no particular injury. And inasmuch as it is not known upon whom the losses will fall, each one is willing to contribute a small sum for protection in case he is one of the unfortunate ones.

The business of a surety company, on the other hand, is to sell to those who are in need of a surety the use of its name and credit for that purpose,—the theory being, not so much that if a large amount of business is written the premiums will take care of the losses, as that only those who are able and willing to fulfill their obligations will be bonded, so that there will be no losses. The premium is considered as a reward to the company for the use of its name and credit.

Insurance deals with conditions; suretyship, with individuals. Insurance protects against loss from the happening of a contingency which is, in a large measure, beyond the control of either of the contracting parties; suretyship protects against loss from the default of a particular person, who is the primary obligor. Insurance assumes that a certain average of losses will occur, and a premium is paid to compensate for those losses; suretyship, on the contrary, assumes that each primary obligor will perform his obligation, and that there will be no losses.

Importance of Making a Proper Selection of Risks.

While it is theoretically possible for a surety company to become surety only for those who are able and willing to perform their obligations, yet, in practice,

losses do occur. This is so because, in the first place, those whose duty it is to select the person to be bonded, have human limitations and cannot exercise an infallible judgment. In the second place, the great majority of risks are neither so obviously safe that it can be stated positively that no loss will result, nor so bad that it can be said that loss will certainly, or even likely, occur. In order for a company to do a substantial volume of business, some of these doubtful risks have to be taken, and the problem is to select such as are reasonably safe.

In order to hold the balance between the desirable and the undesirable risks, and to make a reasonably careful selection, without, at the same time, unduly restricting the business, it is necessary, in each case, to understand the extent and character of the obligation that is to be undertaken, and to determine, so far as may be possible, the ability and willingness of the applicant to perform that obligation. And it is especially important that a proper selection be made in the first instance; for there are comparatively few cases where a bond, when once executed and delivered, can be cancelled before its natural expiration. There is also an essential difference in this respect between insurance and suretyship. A contract of insurance is a private contract between two parties, by which one, for a consideration, agrees to indemnify the other against loss upon the happening of a named contingency; and they may, by mutual agreement, terminate the insurance; or they may, and generally do, by stipulation in the policy, fix

the terms and conditions upon which either party may terminate it.

A surety bond is a contract between three parties; principal and surety on one side, and obligee on the other; and it can be cancelled before its natural expiration, only with the consent of the obligee. Where the obligee is a private individual, firm or corporation, such consent may of course be given; and a stipulation, authorizing the surety to terminate the bond by notice, may be put in the bond. Some bonds do contain such a stipulation, but many bonds are given for the performance of a single obligation, (a building contract, for example); and it would be inconsistent with the nature of the undertaking to permit the surety to cancel before the complete performance of that obligation. In practice, such bonds do not contain a provision for cancellation. Where the obligee is a state, county, city or other body politic, its consent to a cancellation of the bond can be given only by law; and if the law does not make provision for cancellation, no officer, board or court can grant a valid release.

It is important also to make satisfactory provision for the payment of the agreed premium; and herein lies another distinction between insurance and suretyship. The agreed premium is the consideration for a policy of insurance; and if the insured refuses to pay the premium, there is a failure of consideration and he cannot enforce the contract. In suretyship, the principal generally arranges for the bond and agrees to pay the premium; but the validity of the bond, when executed or delivered, does not depend upon the pay-

ment of the premium. A bond is an obligation of the principal and surety in favor of the obligee, and is given in order that the principal may qualify for some office or position. Although the promise of the principal to pay the premium may be the thing that induced the surety to execute the bond, yet the consideration which makes it a binding obligation, and which the law recognizes, is the benefit which accrued to the principal, in that he was, by the giving of the bond, enabled to qualify for the office or position. It follows that the failure of the principal to pay the premium cannot affect the validity or binding effect of the bond. It logically follows, however, that where the obligee arranges for the bond, and agrees to pay the premium, his refusal to pay it, will prevent recovery.

Classes of Bonds.

Surety companies have applications for many different kinds of bonds, but the more important classes are as follows: bonds for private employees, that is, ordinary employees of individuals, firms and corporations; bonds for public officers; for executors, administrators, trustees and other fiduciaries; appeal attachment, injunction, replevin and other court bonds; bonds for contractors; for banks, as depositories of public or private funds; bonds required by the Internal Revenue Department of the Federal Government; bonds required by the customs department; indemnity bonds against loss as a result of issuing duplicates of lost instruments; bonds covering accounts receivable assigned by a merchant as security for a loan; qualifying bonds for insurance companies; and numerous other miscellaneous classes.

Difficulties of Determining What Bonds Should be Issued.

Each of these different classes presents its own peculiar problems. In some cases, such as private employees, honesty on the part of the applicant may be a sufficient guarantee of safety, although the character of his position will affect the probability that he will be honest. In other cases, such as public officers and fiduciaries, not only honesty but ability to perform their duties is necessary. In still other cases, such as appeal bonds, the applicant must have financial responsibility, or collateral security must be required. And finally, there are cases, such as contractors, where the applicant must have all of these elements—honesty, ability and financial responsibility.

In order that a general surety underwriter, as an agent or branch manager, is compelled to be, may intelligently pass upon the applications that will be submitted to him, he must have a wide knowledge of the subject, as well as a clear head and sound judgment. He must be able to recognize indications of probable dishonesty in an applicant, and must know how that probability will be affected by the duties and liabilities, opportunities and temptations of employees, public officers, fiduciaries and others. He must know the elements of strength and weakness in contractors and must know the dangers inherent in particular contracts. He must be able to tell when a bank is in a good sound condition and reasonably safe for depositors, and he must know the chances of loss under different conditions. He must be able to recognize bonds that guarantee the payment of money, and to that end, must often look beyond the surface of things; and where

the bond does guarantee the payment of money, he must know what is necessary for the protection of the surety. In general, he must know the exact character and the extent of the obligation to be assumed by the applicant and must be able to determine, as far as is reasonably possible, whether or not the applicant is able and willing to perform that obligation—whether or not he has the requisite integrity, ability and financial responsibility to warrant the assumption that he can and will measure up to the requirements of the particular case.

Object and Scope of the Book.

It will be the object of the succeeding pages to explain the character and extent of the risk of the surety on the several classes of bonds and to give such information as will enable the underwriter to determine the desirability of the risk. Although this is not intended to be a law book, yet the principal points of law affecting the risk of the surety will be given. The general rule will be stated in the text; and where the rule in the several States is not uniform, the law of each State will be given in annotations.

CHAPTER I.

FIDELITY BONDS.

Section 1.—**Scope.** In a broad sense, all bonds with surety may be said to be fidelity bonds, in that they guarantee the fidelity of the principal in the performance of a duty or obligation. In the sense in which the term is here used, and in which it is generally used by surety companies, it embraces only bonds given by private employees to protect their employers against loss on account of their infidelity. The term "private employees" is here used in contradistinction to public employees or public officers, but where the clerks employed in a public office are not required by law to give bond, but do so at the request of and for the protection of their superior, who, under the law, is liable for their defaults,[1] the regular fidelity bond is generally used, so that the risk of the surety is the same as if they were private employees. In this chapter, therefore, I shall deal with the bonds of all private employees and such public employees as give bond, not to the state in compliance with law, but to their superior, who is liable to the state for their defaults.

Sec. 2.—**The Liability Under Fidelity Bonds.** The ordinary fidelity bond does not, as its name would probably imply, guarantee the fidelity in all respects of the employee—that is, it does not guarantee the full and complete faithful performance of his duties. On the

[1] See Section 36.

contrary, the bond ordinarily issued by surety companies is limited to cover loss resulting only from certain specified acts on the part of the employee. In the earlier days of corporate suretyship, it was deemed prudent to protect the employer only against such loss as might result from acts for which the employee could be criminally punished, as the fear of punishment was, and is, regarded as a very strong incentive to honesty. Accordingly fidelity bonds generally covered only such loss as might result from acts amounting to larceny or embezzlement.

It was found, however, that some courts and many employers construed a fidelity bond to be a guarantee that the principal would not wrongfully and in bad faith misappropriate the employer's money or property; and it often happened that bonds, which by their terms covered only larceny and embezzlement, were liberally construed in favor of the employer, with the result that the surety companies were held liable in many cases where the employee escaped criminal prosecution. At a comparatively early date, therefore, some of the companies began to issue bonds expressly covering all loss resulting from fraud and dishonesty on the part of the employee and most of the other companies soon began to do the same. Recently the companies have been issuing a still broader bond, covering also loss resulting from forgery, misappropriation, wrongful abstruction and wilful misapplication by the employee. It is doubtful, however, if these words actually broaden the liability, as any such act would probably be dishonest or fraudulent. The essence of the risk under almost any form

of bond is the chance that the principal will wrongfully and in bad faith misappropriate the employer's money or property.

Sec. 3.—**Termination of Liability.** It was stated in the introduction that as a general rule bonds with surety could not be cancelled by the surety before their natural expiration. Fidelity bonds are an exception to that rule. They are private contracts between the employer and the surety company and the parties may agree upon such terms as they see fit. And it is entirely consistent with the nature of the obligation that the surety should be permitted to terminate the liability for the future acts of the employee, as the employee may at any time be discharged without seriously affecting the rights of the employer. Accordingly, these bonds usually contain a provision for termination of liability upon ten days' notice, the surety remaining liable for any breach of the bond that may have been committed prior to the expiration of that period, provided such default is discovered within the time fixed by the bond, usually six months or a year after termination.

Sec. 4.—**The Underwriting of Fidelity Bonds.** We now come to our principal object of determining how to "underwrite" these bonds—that is to say, of determining the circumstances under which they may be written and the circumstances under which they should be declined.

We have seen that, whatever may be the particular acts covered by the bond, the essence of the risk or hazard is the chance that the applicant is dishonest and will, if he gets sufficient opportunity, take his em-

ployer's money. In underwriting these bonds, therefore, the essential thing is to be satisfied that the applicant is honest. Honesty is, however, only a relative term. A man who will not take his employer's money under some conditions, may do so under other conditions, so it is necessary to be satisfied not only that the applicant is reasonably honest, but that he probably will not, under the conditions that will exist in the particular case, take any of his employer's money. It is necessary, therefore, to consider an applicant for a fidelity bond from two standpoints—namely: first, his personality—whether, in the abstract, he is honest; and, second, the nature of the position he will occupy—whether, under the particular conditions that will exist, he can be depended upon to resist the temptation to take his employer's money.

In discussing the problems of underwriting, it is not practicable to consider each position or class of positions. It is better to reduce the matter to general principles—that is to say, to point out those things which, when present in any case, tend to show that the employee cannot be depended upon to resist the temptation to take his employer's money. By considering each applicant in the light of these principles, the character and extent of the risk and the chances of loss may, with reasonable accuracy, be determined. In other words, the object will be to fix a standard by which the hazard or risk in any position may be judged.

In order that the subject may be made as clear and specific as possible, an attempt will be made to dis-

tinguish between those things which it is essential to know, and those which it is merely desirable to know; and between those things which make a risk totally unacceptable and those which render it merely not first-class.

Sec. 5.—**The Personality of the Applicant. Antecedents and Environment.** In attempting to determine the probable honesty of an applicant for a fidelity bond, it is important, in many cases, to consider his antecedents, and his early training and environment. Where a man has established a satisfactory record of his own, that record should be the sole guide in determining the manner of man he is; and in that event, it is not necessary to pay much attention to the matter of his ancestry or his early environment. But where the applicant is a young man who has not held responsible positions for as long as five years, and who therefore has not made a substantial record of his own, a consideration of his antecedents and early environment is essential; although there are not many cases where this matter is of sufficient importance to justify the declining of the risk. There are only a few classes of persons whose descendants are *prima facie* unreliable; and the more important of these classes are:

A.—Negroes, who, as a class, have been found to be undesirable risks for a surety company, especially where they will handle money.

B.—The lower classes of foreigners, or even of Americans, particularly those who live in the slums of the large cities, where the atmosphere is not at all con-

ducive to the development of a keen sense of moral responsibility.

C.—Those who have criminal records, or who have been guilty of such serious breaches of the moral law as to indicate that they have criminal instincts.

D.—Those who have very "sporty" tendencies,—whose lives are immoral who drink liquor freely, habitually play cards or otherwise gamble, who work little or none and spend money or contract debts almost regardless of income.

The offspring of these classes may, and very often do, turn out to be fine men; but the percentage of failures is great enough to justify us in the conclusion that a surety company ought not to guarantee the fidelity of such a man until he has established his own record by serving in responsible positions for several years, with a clean record, and good habits.

Sec. 6.—**Habits.** The next thing to be considered is the character of the man himself as it may be indicated by his habits; and in every case this matter should receive most careful investigation and consideration, as it is the most important element in determining the chance of loss. Surety Companies, of course, cannot afford to judge applicants by Puritanical standards, but there are certain habits which experience has shown are likely to lead to defalcations; and while the effect of these habits is well known to the average man and therefore need not be dwelt upon, it seems appropriate at this point to enumerate the more important ones, as follows:

A.—Speculating or gambling on the stock, grain or cotton exchange. This habit has led to very many and very large defalcations, and it is evident that a man who engages in this form of gambling should not be bonded. The bare fact that a man carries, or is suspected of carrying, a margin account with a broker, even though it may be small, is in my judgment, sufficient to warrant an underwriter in declining the risk.

B.—Card playing and similar forms of gambling are generally looked upon with disfavor by underwriters, but as a matter of fact, comparatively few defaults have been attributable to losses at cards; and it seems to me that it is only where a man plays with such frequency or for a large enough stake to materially affect his income, that his application should be declined.

C.—Extravagance and fast living. It is, of course, well known that this habit has led to many defaults, and underwriters look with disfavor upon applicants who have been in the habit of frequenting saloons, pool rooms and houses of ill fame or associating with questionable characters of either sex, particularly if the salary of the applicant is small or apparently insufficient to warrant the expenditures which are likely to accompany these habits. It is, however, manifestly impossible to lay down any general rule as to what is and what is not proper conduct. The underwriter will determine in each case whether or not the applicant engages in these or similar practices to a sufficient extent as to be likely to call for expenditures beyond his income. If there in anything to indicate a reason-

able probability, or even a reasonable possibility, that he will do so, the application should be declined.

D.—The excessive use of alcoholic liquors. This practice not only tends to undermine a man's normal fiber and to weaken his power to resist temptation, but it often accompanies or leads to extravagances or fast living. It often happens that heavy drinking is the only detrimental habit that will develop in the course of the investigation; but, in the absence of definite information to the contrary, it may fairly be assumed that such drinking is accompanied by the usual extravagances and indulgence. Hence, the excessive use of such liquors is of itself sufficient to warrant the declination of an application.

Sec. 7.—**Financial Condition.** As a general proposition, an application for a fidelity bond should be considered and acted upon entirely apart from the financial condition of the applicant; that is to say, while financial strength is a very desirable qualification in an applicant, it is not an essential one. If an applicant is satisfactory in other respects, he may freely be accepted, although he may have no means other than his salary; and if his record and habits are bad, he should not be accepted, even though reputed to have money. However, where an applicant is known to have considerable money, slight imperfections in his habits do not necessarily make the risk undesirable. So also, if his parents or other near relatives are well to do, slight imperfections may be passed, as they may reasonably be expected to come to his rescue in case of trouble.

While a man who has no financial resources may freely be accepted, caution must be exercised with the man who not only has nothing but who is in debt. Such a man will probably be called upon to use a part of his earnings to liquidate the debt and thereby decrease the amount to be devoted to the maintenance of himself and his family.[1] And he may be so hard pressed as to think it advisable to "borrow" from his employer in order to get rid of his creditor. If the debt happens to be due the employer he may "borrow" with one hand to pay with the other, thus imposing upon the surety a liability for what is really a mere debt; and where, he owes the employer, he is more likely to be compelled to use a part of his earnings to repay the loan; and in the event of default, it is probable that any credits to which he might be entitled by way of salary or otherwise would be consumed in liquidating the debt, rather than liquidating the liability of the surety. It is the same way with any property he might have. Therefore, unless the debt is secured by good collateral, it is better to avoid the man who is in debt, particularly if he is indebted to his employer.

Sec. 8.—**The Investigation.** As we have seen it is not always easy to get correct information as to the antecedents, environment, character and habits of an applicant. If we could, perhaps there would not be so much need for bonding companies. About the only sources from which it is practicable to get this information are the applicant himself, the persons to whom he refers, and his former employers.

[1]See Section 14.

The applicant is not likely to give unfavorable information in regard to himself so that this source of investigation is of little value. Likewise it is hardly reasonable to expect that an applicant will refer to people who will intentionally give damaging information regarding him, so it is not well to put much dependence in the replies of the references; and in cases of very small bonds, I believe it will be as well to omit sending out reference letters. Where reference letters are sent out the replies should be considered from at least four standpoints, namely: the standing of the reference, the extent of his acquaintance with the applicant, what he says, and what he fails to say. The standing of the references will have an important bearing upon the probable truth and accuracy of their statements, as well as upon the probable character and standing of the applicant. The man who can get a "certificate of character," so to speak, from a bank president, who is intimately acquainted with him and his family, is likely to be infinitely a better risk than the man who refers to a saloonkeeper, a "bookmaker" or a person having no particular standing.

It is also important to note the extent of the acquaintance of the reference with the applicant. The fact that a man does not refer to persons who know him well is a suspicious circumstance, for almost any man, if he wishes to, can refer to men who do know him well; and the fact that he does not do so may be a sign that those who are well acquainted with him would probably not give a favorable opinion.

It is unnecessary to call attention to the import-

ance of weighing carefully any damaging information given by a reference, for such information may be assumed to be true; but it is also important to note any apparent evasion or omission to answer the questions asked. There are many men who will not deliberately give a false answer to questions of this kind but who will evade them or omit to answer them. This probably results from a natural disinclination to speak ill of others, particularly one's friends; but, in making investigations of this kind, surety companies ought to have the whole truth; and if there is any indication that they are not getting it, they should move cautiously.

The really valuable information concerning an applicant is to be had from his former employers; for a good clean record covering continuous service for as much as ten years warrants the assumption that, in the absence of extraordinary opportunities and temptations,[1] the applicant will continue to be honest; and conversely, if he has been dishonest in the past, he is not to be trusted for the future.

In view of the importance of obtaining the record of the past employment of an applicant, it is essential that he be required to give the name and address of all his employers during the preceding ten years. In order to warrant the acceptance of the risk, it is essential that, if possible, a reply be obtained from each of these employers, confirming the period of the employment as well as giving the applicant a favorable report. If a reply be not obtained, acceptance of the risk should be withheld until a satisfactory explanation is made,

[1]See Sections 9-16.

such as that the employer is dead or out of business and his whereabouts unknown. When a situation like this develops, caution must be exercised and a very careful investigation made, as the name of a fictitious employer may have been given to conceal the real employer, who had an unsatisfactory experience with the applicant.

Given a complete record of the employment of an applicant for as much as ten years, and a showing that that record is clean and free from any suspicion of dishonesty, and that so far as the former employers know, applicant's habits are good, then I think it fair to assume, in the absence of extraordinary opportunities and temptations in the present employment, that he may be depended upon to be honest. In that event, the replies of the references are really of little moment.

Sec. 9.—**The Nature of the Position. In General.** We have been discussing the matter of how to determine whether or not an applicant for a fidelity bond is honest. It has been said, however, that there are no absolutely honest human beings. The cynical saying that "every man has his price" expresses the idea. While most people are unwilling to give credence to any such thought, yet it is a well known fact that the question, whether or not an employee is likely to take his employer's money, does depend in a measure upon the opportunities he will have and the temptations to which he will be subject; and it is manifest that it is not possible to determine the hazard to which the surety for an employee will be subject unless the opportunities, temptations and liabilities incident to the

position are ascertained and unless their effect upon the risk is known.

The opportunities, temptations and liabilities are usually ascertained by requiring the employer to answer certain questions concerning the duties, and liabilities of the applicant and the checks and audits that will be enforced; and it will be my purpose in the succeeding pages to discuss the possible opportunities, temptations and liabilities of employees, with a view of determining their effect upon the risk of the surety.

Sec. 10.—**Opportunities. The amount of money to be handled.** It is of course manifest that the risk bears some relation to the amount of money that will come into the hands of the employee, and the amount that will be on hand at one time. In the case of employees in the main office of the employer, the amount of money to be handled is not an important consideration, as it may be assumed that the risk is in proportion to the amount of the bond. But in the case of employees who are away from the main office—agents, branch managers, solicitors, collectors and the like—it is important not only to consider the amount of money likely to be on hand at any one time, but also to see that they are required, at frequent intervals, to turn in all money received, so that they will not, in ordinary course of business, have on hand a large sum. There may be nothing to prevent them from neglecting to account for some of the money that has come into their hands, but the fact that an accounting is necessary has a restraining effect, and accountings should be required

not less than once a month; and in the case of such employees as drivers for laundries, and the like, daily accounting should be made. These requirements should be a condition precedent to the issuance of the bond.

Sec. 11.—**Extent of control over Employer's Money.** Where the money is to be handled solely by the applicant and where he could take it without the knowledge or consent of any other person, the opportunity is practically unlimited; and it is lessened to the extent, that it is necessary for him to obtain the consent or collusion of another, or to bring a defalcation to the attention of another. Where, for example, one man has exclusive control of an office and personally handles the cash, or has such control over it that no one else would observe or take note of a defalcation; where a man has the right, without counter-signature, to check against the employer's bank account, or to draw on the employer; where a man is acting as both bookkeeper and cashier so that he could himself "doctor" the books and cover up his shortage; where a man is on the road having the custody of his employer's goods, or collecting or disbursing his employer's funds—in all these cases, the opportunities are practically unlimited, and the only safeguard is to audit very frequently the books and accounts of the employee and to verify the cash on hand and outstanding. It is not necessary to decline all applications where the opportunities are thus unlimited, but it is necessary to be sure that the personality of the applicant is up to the highest standard, and that frequent audits will be made.

Where, on the other hand, though a man has control over an office, yet the funds are actually handled, and the books kept, by another, so that, barring secret personal collections made outside of his regular duties, no money would come into his hands; where countersignature is necessary on checks and drafts; and where one person is cashier and another, bookkeeper, so that neither could easily get any money without the collusion of the other, the risk is lessened. In the case of collectors and other traveling men, it is almost impossible to limit their control over the funds or property in their hands, and, as we shall see, the risk on such employees is very great and can be limited only by frequent audits. A promise by the employer to make frequent[1] and thorough audits should be a condition precedent to the execution of bonds for such employees, and even then they can be issued only when the conditions of the employment are satisfactory.[2]

Sec. 12.—**Opportunity to conceal Shortage.** A man may have abundant opportunity to take his employer's money, but he is not likely to do so, if it is certain that the defalcation will be discovered immediately or at the end of a few weeks. It is of the utmost importance therefore, in cases where the opportunity is great, to require the employer to promise to make very frequent, as well as efficient, audits of the books and accounts of the employees and to verify the cash on hand or outstanding.

[1]See next Section.

[2]See Sections 12-19.

Such audits are likely to result in the discovery of a shortage before it has gone very far, as defaulters usually begin by taking small amounts; and the knowledge that such audits are to be made is likely to have the effect of deterring the employees from committing any default.

Competition has driven the surety companies, in the case of banks and a few other high grade institutions, to waive the requirement for periodical audits. Indeed in some cases, employer's statements are waived altogether. This is done on the assumption that a careful supervision over the employees will be exercised; that, in any event, the opportunities are rather limited; and that audits will in fact be made at least once a year. In most cases, it is not deemed proper, or consistent with reasonable prudence, to omit to require periodical audits. Audits made in accordance with the following schedule will generally be satisfactory and should be required:

A. The main office should be audited by an outside expert accountant once a year.

B. Agents and branch managers once in six months, and all outstanding accounts should be verified.

C. Collectors, as we have seen, should be required to account at least once a month; and as soon as an account is in arrears, a bill should be sent direct by the employer to the customer.

D. Drivers who collect should be required to account daily, and the employer should be required to send bills directly to customers who are in arrears.

The employer ought in all cases to be required to give the surety prompt notice of the discovery of a default or probable default on the part of an employee, as otherwise the audit and checks would be of little value to the surety, and the employer could retain in his service a man who was known to be a defaulter, or could deliberately permit the employee to escape and nevertheless have the protection of the surety company.

Sec. 13.—**Temptations. In General.** Opportunities may exist, but if there is no strong incentive or inducement to take the employer's money, an employee is not likely to do so, as normal human beings, in the absence of special temptations, are not prone to take property that does not belong to them.

We have already discussed, under the title of the personality of the applicant, the strong temptation that may result from gambling, speculating, extravagance and fast living. It is important also, to consider any special inducement or temptation peculiar to the particular position. The more important of the temptations, which are shown by the records of surety companies to have an influence on the risk, will be indicated, so that the underwriter may, in the light of the employer's statement, look out for them in each case and be governed accordingly.

Sec. 14.—**Inadequate Compensation.** One of the temptations that may be inherent in a particular position is that of inadequate salary. We are not now referring to the inadequacy that may result from extravagance or fast living; that has already been consid-

ered.[1] We are now referring to the case of a man who is forced to accept a position, the salary of which is not actually sufficient to enable him to support those dependent upon him in the manner to which they have been accustomed. The author recalls a case where a man was the manager of a branch store of a large tailoring concern, receiving a salary of $18.00 per week. Under some circumstances, this might have been sufficient, but he was about forty years of age and had held a better position; he had a wife and several children dependent upon him for support, and he was expected to dress well and keep up appearances in order to sell goods. Though he lived modestly in a small apartment, his wife doing all the housework, and though they spent practically nothing on amusements, he found at the end of a certain week, that he did not have quite enough to pay his household expenses, so he took out of the cash drawer, enough to make up the deficiency, intending to pay it back with next week's salary. Instead of paying it back, he found it necessary to take more; and this practice continued, despite every economy he could reasonably practice, until the traveling auditor, in making his semi-annual trip, discovered the shortage and discharged him. Another case was where a young man holding a respectable position in an affice, in a large city, with a salary of $65.00 per month decided to marry. He found it impossible, though he lived modestly, to pay his necessary expenses; and having access to his employer's money, took a little to make up the deficiency. The practice

[1] See Section 6.

continued until, at the end of about six months, the shortage was discovered. Instances could be multiplied; but these are sufficient to make it clear that, though a man may have a good record, may have no bad habits and may live modestly, yet if he is not making enough for his needs, considering his station in life and the number of persons dependent upon him for support, he is not a good risk. What is an adequate salary will of course depend upon the facts and circumstances of each case, and no general rule can be made.

Sec. 15.—**Where Amount of Compensation Varies.** This matter of compensation is particularly important when the employee is paid by commissions so that the amount of income is indefinite or uncertain, varying with the amount of business done. When such a man has had a bad month and does not earn the amount he has been in the habit of spending, the temptation to assume that the next month's business will be greater and to anticipate the income from the expected increase by "borrowing" a little from the employer is very great; and this class of bonds should on this account, be regarded as hazardous. The fact that such employees cannot generally be punished for taking their employer's money is an additional, and very serious hazard, which will be referred to in the next section.

Sec. 16.—**Where there is no Power in the State to Punish a Defaulter.** Most men are deterred from taking property that does not belong to them by their own consciences; others, by the fear of public disap-

proval; but there are still others who are not deterred by anything short of the fear of punishment. Therefore the reputation for relentless prosecution of unfaithful bonded employees, which the bonding companies have gained, is believed to have materially lessened the number of such unfaithful employees; and impending imprisonment has induced the relatives of many a defaulting employee to come to his rescue. Accordingly it was formerly thought necessary to the proper conduct of the surety business to impose a condition that, in event of a default, involving the commission of a crime, the employer would lay information before a proper officer and verify the same as required by law, to the end that a warrant for the arrest of the employee might be issued. Recently the companies have, in particular cases, been waiving this requirement, but in view of the advantages often to be derived from the prompt arrest of a defaulter, surety companies ought to be slow to do so, although, of course, it may be good business policy where the volume of business is large, and where, as a matter of fact, the employer intends to cause the arrest of any of his employees who may commit criminal acts. In due season, the surety company might be able to get the information before the proper authorities, but in the meantime, the defaulter may have absconded. Where the bond covers only larceny and embezzlement, such a provision (in theory at least) imposes upon the employer the obligation of laying the information before the authorities or abandoning his claim, and amounts to a reasonable assurance that the surety will not be held for a default unless the defaulter

can and will be prosecuted. Where the broader form of bond is issued, the employer, notwithstanding such a provision, may decline to swear out the warrant for the arrest and nevertheless will not be estopped from contending that the act comes within the scope of the bond.[1]

It is evident from what has been said that if, notwithstanding such a provision in the bond, an unfaithful employee cannot be prosecuted, the chance of loss on the part of the surety is increased. And it is a well established principle of the law of some of the states that, where an employee receives money for joint account of himself and his employer; that is, where the employee is entitled to a percentage of the money so received, he cannot be punished for failing to turn over to the employer the latter's share of the money. The employer and employee are regarded as partners or tenants in common of the fund; and it is not a crime for partner or tenant in common to take and use the common property to the exclusion of the other partner. The remedy of the other partner is a civil action for the division of the common property and for the recovery of his share. So, in the states where this rule prevails, an agent or other employee, who receives his compensation in the shape of commissions on money collected may with impunity, so far as punishment is concerned, convert the employer's share of the money so collected; and consequently such risks are not desirable. So far as this phase of the risk is concerned, it would seem to make no difference whether the entire compensation of

[1]See Section 2.

the employee is paid by commissions, or part of it as salary and part as commissions. In either event, he would have an undivided interest in all the money that would come into his hands, and therefore the rule would seem to be applicable.

While business policy will often require the taking of one or more employees on commission, along with a number of others on salary, yet, as a general rule, such employees are not desirable risks for a surety company; and they should not be accepted unless they measure up to a very high standard or have very considerable financial responsibility.

Sec. 17.—**Liabilities of Employee—In General.** We have seen that the surety on a fidelity bond is liable only for loss resulting from certain specified acts on the part of the employee; but in underwriting these bonds, it is well to take into consideration any extraordinary liabilities that may be incident to the position, as they may have a material effect upon the risk of the surety. Such extraordinary liabilities usually result from the terms of the contract of employment; and attention is directed to the matter to the end that this feature may not be overlooked. One or two of the more important liabilities will be treated in some detail.

Sec. 18.—**Liability for Stock Shortage.** Employees who have the custody of merchandise away from the main office of the employer are generally charged with the quantity sent to them, and are required periodically to account for the amount shown by the employer's books to have been received. If they cannot satisfactorily account for or explain the disappearance

of any part of the merchandise, they will be held liable for that amount. Managers of coal and lumber yards are typical examples. Notwithstanding the surety cannot be legally held for loss that does not result from an actual misappropriation, bonds of this kind are generally unsatisfactory.

A. Merchandise, when delivered in wholesale quantities, and retailed, is very apt to run short to a certain extent, and some of it may be taken by third persons. It is therefore difficult in some cases to tell whether the shortage represents a misappropriation or not; and the surety is likely to be called on to make good a shortage where the principal denies having made a defalcation, and when there is every reason to believe he is telling the truth. While the surety may not be held liable, there is apt to be some litigation and expense, resulting perhaps in a compromise settlement.

B. In case of an admitted defalcation, claim is likely to be made for the whole shortage, no credit being allowed for the natural or inevitable shortage.

C. Even if the employer attempts to recover from the surety only the actual defalcation, he will likely take advantage of any set-offs, by way of salary or otherwise, and exhaust the resources of the employee in making up the shortage, leaving the surety to pay the defalcation without any chance of reimbursement from the principal.

In such cases the bond should not be written unless the employer has established a reputation for fair dealing, and the merchandise is reasonably well protected

from possible depredations by third persons, or unless the applicant has some considerable financial strength. However, where there are a few such employees on a large schedule, it may be reasonably prudent to accept them along with the rest.

Sec. 19.—**Liability for Uncollected Accounts.** In many cases, agents, branch managers and the like are, by their contracts with their employers, liable for all, or a certain percentage, of the bad bills or uncollected accounts. While the surety is liable only for such money as actually comes into the hands of the employee and is misappropriated by him, yet the risk is undesirable because:

A. The liability for uncollected accounts imposes a heavy burden upon the principal, and may decrease his net earnings to such an extent that there will be the temptation that usually results from inadequate or uncertain earnings.[1]

B. In event of default, the employer will likely take advantage of any set-offs by way of salary or otherwise and exhaust the resources of the principal in making up the liability for uncollected acounts, leaving the surety to make up the defalcation with no chance of reimbursement.

In such cases, the bond should not be written unless the applicant is quite strong financially—undoubtedly strong enough to take care of any reasonably possible liability for uncollected accounts without impairing his means of support.

[1]See Sections 14-15

CHAPTER II.

PUBLIC OFFICIAL BONDS.

Sec. 20.—**Scope.** The bonds that will be next considered are those required by law to be given by persons holding positions of public trust. They are known as public official bonds; and this title includes the bonds of officers of the United States, of the states, of counties, municipalities and other political sub-divisions.[1]

Sec. 21.—**Form of Bond and Liability in General.** There is a marked difference between the liability on a public official bond and that on a fidelity bond. We have seen that a fidelity bond covers only certain specified acts on the part of the employee, such as fraud, dishonesty and the like,[2] and that the bond is usually subject to certain conditions limiting the surety's liability. A public official bond, on the other hand, generally guarantees the faithful performance by the officer of all the duties required of him by law, and as a rule cannot be made subject to any restrictions upon the liability of the surety. The surety is liable, therefore, not only for any public money the officer may convert to his own use, but also for any loss resulting from the failure of the officer to perform his duties or from the negligent or improper manner in which he performs them.

It is to be borne in mind, in this connection, that as a rule it is not feasible or useful to put in the bond conditions limiting the surety's liability as fixed by

[1]See Section 1.
[2]See Section 2.

law. Such a bond would probably not be accepted; and if it were, the conditions would probably be declared void by the courts. Although some states sustain the validity of such conditions, most of them do not; and, as a general proposition, if a bond is not a good risk on the statutory form, it should not be issued.

Sec. 22.—**Termination of Liability.** The bond of a public officer generally covers the full term for which the officer was elected or appointed. And, inasmuch as the bond is a contract between the principal and the surety, on the one hand, and the people of the state, county or city, on the other, it is clear that only the people, acting through their law-making body, can relieve the surety of his obligation during the term. The fact that the principal may be willing to give another bond, or that he may neglect to pay the annual premium, provided for in his contract with the surety, can have no effect upon the surety's liability.[1]

In some states, there is a statute, under authority of which, the surety on certain public official bonds may obtain a release from future liability.[2] Such statutes

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1For a more complete discussion of this point see Section 74.

2ARKANSAS.—Surety for any public officer may petition the proper court for release and the court, upon hearing, may, in its discretion, grant the petition. Secs. 7931-37, Kirby's Digest.

CALIFORNIA.—Surety for any city, town, county or state officer may effect a cancellation as to future liability. Secs. 972-77, Political Code

COLORADO.—Surety for any state, county or municipal officer may effect a cancellation as to future liability. Sec. 935, Colorado Statutes Annotated. See also Secs. 4688-91, Colorado Statutes.

GEORGIA.—Surety for any public officer may be released from future liability by the Governor of the State. Sec. 301, Code of Georgia, 1911.

IDAHO.—Surety on the official bond of a city, district, precinct, county or state officer may effect a cancellation as to future liability. Revised Codes, Secs. 306-311.

ILLINOIS.—Surety for any state officer or agent, or county, town, city, village, incorporated town or other public officer may effect a cancellation as to future liability. R. S., 1909, Ch. 103, Secs. 10-11, P. 1563. As to county collectors, see also Ch. 120, Sec. 149, P. 1851.

are extremely useful when a risk which appeared in the beginning to be good, turns out to be undesirable; and they no doubt lessen the chance of loss.

INDIANA.—Surety on any official bond may effect a cancellation as to future liability. Burn's Anno. St., Secs. 9128-33.

IOWA.—Surety for any public officer, deputy, or employee of such public offices or any officers or employee of any public or private corporation or association may effect a cancellation as to future liability. Code of Iowa (Supp. 1907), Sec. 1177-b.

KENTUCKY.—Surety on any official bond may effect a cancellation as to future liability and may in some cases obtain indemnity for such as may have been incurred. Sec. 4659, Carroll's Kentucky Statutes, 1909.

LOUISIANA.—Surety on any official bond, state or parochial, may obtain release from future liability if he alleges that he has good cause to fear that the officer will render him liable by reason of misfeasance, malfeasance or neglect of duty, and if the court is satisfied that the apprehensions of the Surety are well founded. Act 46, 1880, P. 46. Wolff's Rev. Laws of 1904, P. 1791.

MARYLAND.—Surety for any state, county, municipal or other public officer may effect a cancellation as to future liability. Art. 90, Sec. 7, Annotated Code.

MINNESOTA.—Surety for county officers may effect a cancellation as to future liability. General Statutes, 1913, Secs. 1083-85.

MISSISSIPPI.—Surety for any county or county district officer may petition the Board of Supervisors for release from future liability, and the board *may* order the officer to give new bond and release former Surety. Code of 1906, Sec. 3470.

Surety for state officer may effect a cancellation as to future liability. Code, 1906, Sec. 3471.

MISSOURI.—Surety for any officer may be released from future liability by the court authorized to take and approve the bond, but the matter is in the discretion of the court. Rev. Statutes, 1909, Secs. 11281-88.

MONTANA.—Surety for any city, town, township, county or state officer may effect a cancellation as to future liability. Political Code, 1907, Secs. 403-6.

NEVADA.—Surety on the official bond of any state, county or city officer or on the bond or undertaking of any person where by law a bond or undertaking is required may effect a cancellation as to future liability. Rev. Laws, 1912, Secs. 2880-82.

OHIO.—Surety for sheriff, auditor, probate judge, county treasurer, Clerk of the Court of Common Pleas, recorder, coroner, infirmary director or county surveyor, may be released on petition, if in the opinion of the County Commissioners there is good reason therefor. Secs. 5837-8, Bates Anno. St.

Surety for a constable or the marshal of a municipal corporation may effect a cancellation as to future liability. Sec. 5839. Bates Anno. St.

Surety for treasurer of school funds may be released if in the opinion of the Board of Education there is good reason therefor. Secs. 5841-2, Bates Anno. St.

Sureties for township officers may be released if in the opinion of township trustees there is good reason therefor. Secs. 5843-4, Bates Anno St.

Surety for County Commissioners may effect a cancellation as to future liability. Bates, Sec. 844.

SOUTH CAROLINA.—Surety of any officer elected or appointed to any office may effect a cancellation as to future liability. Code of 1902. Secs. 597-8.

TEXAS.—Surety for any county officer may effect a cancellation as to future liability. Sayle's Civil Statutes, Arts. 3576-9.
under decree of a court may effect a cancellation as to future liability.

VIRGINIA.—Surety for any officer, or commissioner or receiver Pollards Code of 1904, Sec. 2887 2889.

Sec. 23.—**The Underwriting of Public Official Bonds.** We are now prepared to take up the main object of the chapter, namely, the question when these bonds may be written and when they should be declined. In doing so, we will follow the general plan that was adopted with reference to fidelity bonds; that is to say, we will not attempt to treat specifically the risk on each different bond or class of bonds, but will point out the more important risks or chances of loss to which sureties on public official bonds generally are subject, and thereby reduce the matter to general principles, so that the underwriter may, in the light of those principles and the law of the particular state, accurately determine the risk in any particular case.

The surety on a public official bond, like the surety on a fidelity bond, may be in danger of loss either because of something in the personality of the principal or because of the nature of the duties he will be required or expected to perform; and the subject will be treated from those two standpoints.

Sec. 24.—**The Personality of the Applicant. In General.** We have seen that in considering the personality of an applicant for a fidelity bond, it is necessary to be satisfied only that he is honest, for the only

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WASHINGTON.—Surety on the official bond of any state, county or city officer or on any bond or undertaking of any person where by law a bond or undertaking is required may effect a cancellation as to future liability. Ballinger's Code, Secs. 1529-32.

WEST VIRGINIA.—Surety on any official bond may be relieved from future liability. Necessary to state the ground upon which he believes he is likely to sustain pecuniary loss, but action by court, board or officer imperative. Code, 1913, Secs. 271-2.

WYOMING.—Surety for treasurer of school funds may obtain release from future liability "if in the opinion of the County Commissioners there is good reason therefor." Compiled Statutes, Sec. 5027.

Surety for any state, county or municipal officer may effect a cancellation as to future liability. Compiled Statutes, Sec. 285.

obligation of the surety is to see that the principal does not fraudulently misappropriate the money or property of the employer.[1] But the surety for a public officer is bound, not only to see that the principal does not personally misappropriate any of the public money in his custody, but that he fully performs the duties required of him by law.[2] It is necessary, therefore, to investigate the personality of the applicant from the standpoint of his efficiency as well as his honesty.

Sec. 25.—**Honesty.** In attempting to ascertain whether or not an applicant for a public official bond is personally honest, the same general principles will apply as in the case of fidelity applications, and reference is made to the appropriate sections.[3] However, it is not always practicable to require a complete record of the past employment of the applicant, so that the only available sources of information are the applicant himself, the persons to whom he refers, and such personal knowledge as the surety company's representative may have or may be able to get from outside sources.

In making the investigation through the references, the suggestions that have been made regarding fidelity applications will be applicable.[4] But the most reliable information is not to be obtained from the references, who are likely to be the applicant's close personal and political friends. In the course of political campaigns, the record of the candidates generally becomes public

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1See Section 2.
2See Section 21.
3See Sections 5-7.
4See Section 8.

property, so that if the surety's representative is "alive" he will not have to rely upon the statements of applicant's friends, but will have the views of his political enemies as well. There is really no excuse for ignorance on the part of an agent as to the standing of an elected officer; and appointees to offices of any importance are generally well known too, so that by making inquiries here and there, reliable information can be obtained without depending upon the references.

Sec. 26.—**Efficiency.** We have seen that, because the surety for a public officer is liable for the faithful performance by him of his duties, it is necessary to be satisfied that he is reasonably qualified to perform the duties of the office. It is not, of course, necessary that he should be familiar with the details of the particular office, nor that he shall have been trained in that particular work. But, as a general proposition, where a man is taken directly from the farm or the workshop, with no training in business or in accounting, and put in charge of a public office where he will have large sums of money to handle, or other duties for which he has had no training, the result is not likely to be satisfactory. His business methods are apt to be so lax, and his books kept in such poor shape, that it will be difficult for him to tell where he stands. He is likely to get personal and public funds mixed, and, inadvertently perhaps, to use some of the latter for himself, and he is likely to make errors of one kind or another resulting in the loss of public money, for which he will be held accountable. The matter is a very important one, for it is well known that public officers are selected

much less for their fitness than for their popularity or political influence.

Large and important offices are generally filled by men of intelligence and a fair business training; and moreover, in such offices there is usually a deputy upon whom the actual management of the office falls, and who has been holding office from term to term and is thoroughly qualified. The principal danger from inefficiency lies in the smaller offices in the country, where a man with little or no education and absolutely no clerical experience is elected or appointed to fill an important office such as county treasurer, tax collector, or sheriff.

It is difficult to say when it is necessary to decline an application because of the supposed inefficiency of the applicant. The most that can be done here is to call attention to the point, and to suggest that a bit of common sense be used, taking into account the duties and liabilities incident to the office[1] and considering whether the applicant has the experience and training that will reasonably fit him to fulfil those duties and protect himself against the liabilities.

Sec. 27.—**Financial Resources.** If an applicant happens to be well fixed financially, that fact will, of course, operate in his favor in the consideration of his application, as a man who has something to lose can generally find a way to conduct his office so as not to subject himself to any liability. However, the application should first be considered entirely apart from the question of the financial worth of the applicant.

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[1]See Sections 28-40.

If a careful investigation shows him to be honest and qualified to fulfill the duties and obligations of the particular office, the risk may be accepted regardless of his financial worth. It is only where the applicant does not strictly measure up to the requirements that his finances are to be considered. However, if a man does not appear to be reasonably free from suspicions of dishonesty, a surety company ought not to go on his bond, even though he may be reputed to have money. But where the defect lies in the question of his ability to fill the office, then the fact that he is worth a substantial sum may be permitted to turn the scales in his favor. In view, however, of the fact that a man's net worth is difficult to ascertain and that men often live and act as if they are well fixed when they are in debt, the supposed wealth of an applicant should not be given too much weight.

Sec. 28.—**The Nature of the Office. In General.** In order to determine whether or not an applicant has the proper qualifications for the office in question, it is necessary to consider the nature and extent of the duties of the office, as well as the opportunities, temptations and liabilities to which the applicant will be subject. In treating the matter here, we will, in accordance with the plan previously outlined, make no attempt to enumerate the duties, liabilities, opportunities and temptations of each particular office, or even of each particular class, but will treat these matters with reference to public offices generally, so that the underwriter may be aware of the possible dangers and lookout for them in each case. Reference will be made especially

to those hazards which the surety may have an opportunity, before signing the bond, to make arrangements to lessen or avoid.

Sec. 29.—**Opportunities, Temptations and Liabilities. In General.** In determining the hazard on a public official bond, from the standpoint of the character of the office, the first thing that naturally presents itself for consideration is the nature and extent of the opportunities and temptation that will be afforded. Generally, these elements are present in direct proportion to the amount of money the officer will handle, the ease with which it could be converted to his own use, and the probability that a conversion could be concealed for a considerable length of time. The matter will be treated from these three viewpoints, and then we will take up the matter of liabilities.

Sec. 30.—**The Amount of Money to be Handled.** It is, of course, apparent that the opportunity of a public officer to misappropriate public money, and the temptation to do so, are in direct proportion to the amount of money he will handle and the amount he will have on hand at any one time. Likewise the chance of loss as a result of the negligence or incompetence of the applicant or the acts of his clerks or third persons is in proportion to the amount of money to be handled and the amount likely to be on hand at one time.

While it is hardly ever necessary to decline an application merely because the applicant will have the custody of large sums of money, yet, where the amount is large, it becomes the more essential to make ade-

quate and proper provision for its safe keeping;[1] and the matter of the efficiency of the applicant becomes more important.[2]

Sec. 31.—**The System of Checks.** The next point for consideration is the ease or difficulty with which the applicant could convert public money to his own use. It is, of course, very seldom, if ever, possible to so arrange matters that an officer having the custody of public money could not convert it, but anything that tends to check the freedom with which he could do so, without being immediately discovered, is a safeguard. Where the bulk of the money that comes into the office is in cash, and where the case is directly handled by the officer himself, and is disbursed on his sole order, the opportunity is greatest. And the opportunity is lessened to the extent that the money is paid into the office by checks so drawn that the officer will likely have to deposit them to the credit of the state, county or city, as the case may be; to the extent that the money is handled, not by the officer himself, but by deputies and clerks, who are bonded; and to the extent that counter-signature is necessary in order to withdraw money from the depositories.

It is not always necessary for a surety underwriter to accept or reject an application as it stands, as the suggestions of a surety company looking to an improved systems of checks are often welcomed and adopted. The checks above named, and any others that may suggest themselves in particular cases should

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1See Sections 35-37.
2See Section 26.

be applied as far as possible; and if the checks that will be applied are not reasonably efficient, then the requirements as to the personality of the applicant must be strictly enforced

Sec. 32.—**Ease or Difficulty of Concealing Shortage.** It is seldom that an officer misappropriates public money if he knows or has every reason to believe the defalcation will soon be discovered. He generally yields to the temptation either under the assumption that he will be able to pay it back before the shortage is discovered or that he can conceal the shortage so effectually that it will not be discovered at all.

Where there is to be no audit of the office there is little or no difficulty in concealing a shortage; and almost any officer who handles money could, under those circumstances, take some of it without being discovered until the end of his term. But the opportunity to conceal differs in different cases, and in each case the circumstances should be noted in the light of the following principles:

A. The opportunity is lessened where the officer is required periodically to account for and pay over the balance in hand and is not permitted to continue throughout his term to retain all public money received less that expended. There may be nothing to prevent him from neglecting to account for some of the money, but the fact that an accounting is necessary is a safeguard; and if the accounting is required with reasonable frequency, say once a year, and is required to be in full of all funds received to date, the bond may be written without regard to the financial worth

of the applicant, so long as his personality is up to the standard.[1] But where no such accounting nor any satisfactory audit is to be made, it is generally best to decline the business unless the applicant has some financial responsibility,—at least equal to one fourth the penalty of the bond. This, however, may be waived where the personality of the applicant is in all respects up to the highest standard.

B. Where, although he is required to make annual accountings, yet, before he is required to account for the first annual fund, he begins to receive the second, so that a defalcation out of the first year's fund could be made up out of the second, the good effect of the accounting is nullified. This principle is illustrated in the case of tax collectors, where they are not required to account in full for the taxes collected during one year until after they begin to collect for another year. Such an officer could carry along a shortage for an indefinite period, and the matter should be considered just as if no accounting were required.

C. Likewise, where the officer is the collector or custodian of two or more different funds and is not required to account for all the funds at the same time, so that he could use the balance of one to pay up the other, the good effect of the accounting is nullified. This is illustrated in the case of tax collectors who, for example, collect county and school taxes and make their accounting for school taxes at one time and for county taxes at another, so that they could use second year's collection of one to make up a shortage in the

[1] See next section.

first year's collection of the other. In all such cases, the matter should be treated just as if no accounting were required.

D. The opportunity is lessened where, though the officer is not required to account, there are certain times during the year when the expenditures will nearly equal the receipts, so that there will be only a nominal balance in hand. In that event the officer cannot, without being discovered, take more than an amount equal to this balance. Inasmuch, however, as the size of this balance cannot be definitely known in advance, and may be quite large, it is not well to put much dependence in this supposed safeguard.

Sec. 33.—**Frequency and Efficiency of Audits.** As a matter of fact public officers do not generally have such unrestricted opportunities and temptations as those outlined in the last section. In nearly all states, counties and cities there is an auditor of public accounts who is expected at certain intervals to audit and examine the different public offices under his jurisdiction. This is an important safeguard, for it is seldóm, that a public officer misappropriates a large sum at one time. He generally begins by using small amounts with the intention perhaps of replacing the money at the first convenient opportunity. If, therefore, any peculations of an officer are likely to be discovered by an auditor soon after they have started, the risk of the surety is greatly lessened, for the probability of discovery operates not only to prevent large losses, but is instrumental in preventing any loss.

In considering applications for bonds of officers who handle public money, investigation ought to be made to ascertain if there is an auditor in the particular jurisdiction, how frequently the particular office will be audited, and the standing of the auditor and his reputation for efficiency. If there is no auditor, or if efficient audits will not be made at least once a year, the bond should be written only if the personality of the officer measures up to the highest standard, or where the applicant has considerable financial responsibility, at least equal to one fourth the penalty of the bond.

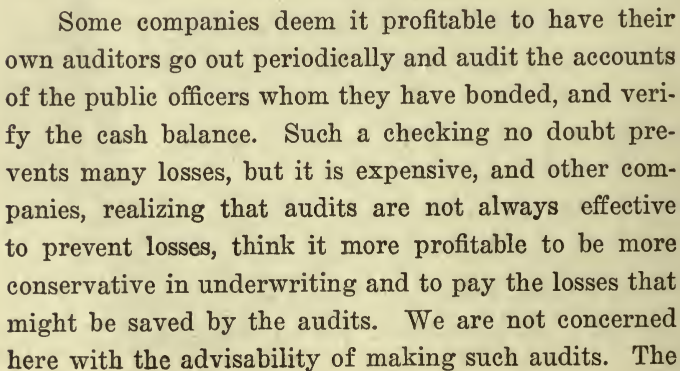
Poor audits may be the result of the fact, that the law does not give the auditor full power and authority to make the audits or does not provide the requisite clerical assistance; that the auditor has not the requisite ability; or that he belongs to the same clique of politicians as the officer whose accounts he is to examine, and may therefore fail to discover evident irregularities for fear of its "effect upon the party." These several aspects of the matter should be considered in each case.

In considering the probable efficiency of an audit, it is well to bear in mind any special difficulties there may be in making an accurate check. Where for example, the officer is the collector or custodian of two or more different funds, each of which will be audited by a different auditor at a different time, the officer could exhibit the same money as the balance of each fund, so that a shortage would not necessarily be discovered. It is necessary that a complete audit of all

the funds be made at one time and that the officer be required to show at the one time the total or aggregate balance of all the funds. If this is not to be done, the audits will not amount to anything and should not be considered.

So also where it is difficult or impossible to tell what funds have come into the hands of the officer, an audit will not be effective. This is true to a greater or less extent in practically all cases, and shows the importance of not relying too much on audits; and, in some cases, an audit is of no value whatever. Take the case, for example, of a tax collector who is not required to account fully for the first year's taxes before beginning to collect for the second year. It is generally an easy matter in that case for a collector, who is short, to deceive the auditor by reporting that he has not collected certain taxes which in fact he has collected.

In general, it may be said where it is not possible to check the receipts of the officer, it is not well to put any dependence in an audit.



Some companies deem it profitable to have their own auditors go out periodically and audit the accounts of the public officers whom they have bonded, and verify the cash balance. Such a checking no doubt prevents many losses, but it is expensive, and other companies, realizing that audits are not always effective to prevent losses, think it more profitable to be more conservative in underwriting and to pay the losses that might be saved by the audits. We are not concerned here with the advisability of making such audits. The

point is that such audits are likely to be at least as effective as audits by public auditors, so that where private audits will be made, the underwriters do not have to concern themselves so much with audits at public expense.

Sec. 34.—**Where Applicant Held the Office During the preceding Term.** Where an officer serves for two or more successive terms, and has a bond with different sureties for each term, the sureties on the bond for the last term are liable for all money in the hands of the officer at the time of the execution of the bond; and it will be presumed that the principal had in his hands, at that time, all the money that he ought to have had. In other words, where an officer is short at the end of his first term and applies moneys coming into his hands during the second term to the payment of that defalcation, the surety on the second bond will be held liable for the defalcation thus made during the second term.

It appears not to be difficult for public officers to conceal a shortage; and therefore, when a new surety goes in for a second term, he may not only be bonding a man who has defaulted, and who therefore may be expected to do so again, but actually assuming liability for an existing shortage. As a rule, therefore, hold-overs who handle money are and should be on the prohibited list, and the prohibition should not be waived unless the applicant is worth, in net available assets, an amount at least equal to half the penalty of the bond, or unless there is convincing evidence that there is no existing default. The evidence, as to the correctness of the accounts, should be based on a genuine audit of

the books and accounts of the officer by an expert accountant and an actual verification of the cash shown by the books to be on hand. And it should be borne in mind that unless it is practicable to tell exactly how much money has come into the office,[1] the audit will not be satisfactory, and in that event the bond should not be written unless the applicant is worth an amount at least equal to half the penalty of the bond.

Sec. 35.—**Liabilities—For Loss by Bank Failure.** Let us now consider some of the liabilities to which public officers are subject, and against which they and their sureties should be protected. One of the duties of a public officer is to account for and pay over all money that comes into his hands; and when he gives bond for the faithful performance of his duties, he and his surety become insurers that the money will be paid in accordance with law; and generally no excuse, except such as may have been specifically provided for by law, will avail to relieve the principal and surety of this responsibility. If therefore the bank in which the officer deposits the money under his control should fail, the officer and his surety would be liable for the resulting loss, notwithstanding care had been exercised in the selection of the bank.

In recent years, many states, counties and cities have provided by law for the selection of depositories for their funds; have required these depositories to give bond for the safe keeping and proper payment of the funds on demand; have required officers to put funds under their control in these depositories, and

[1] See preceding section.

have relieved the officers of liability in case of the failure of such banks. In order, however, that the officer and his surety may be thus relieved, it is absolutely necessary that the depository law be strictly complied with; that is to say, the depositories must be selected or designated in exactly the manner pointed out by the statute, and they must give bond and otherwise qualify exactly as fixed by the statute, and they must not have on deposit at any one time an amount in excess of that for which they can legally qualify as depositories The fact that strict compliance with the law may have been waived by some officer, or not required, does not affect the case; for the loss will fall on the officer and his surety unless every detail of the statute is complied with.[1] In this connection, it should

[1]The laws of the several states on this subject may be summarized briefly as follows:

ALABAMA.—*State Treasurer* and other custodians of state funds may be relieved by depositing funds in state depositories designated by the Governor, provided the banks deposit with treasurer registered bonds of the State of Alabama equal to the deposits, and provided deposits do not exceed capital, surplus and undivided profits of the bank. Code, 1907, Secs. 641-55.

ARKANSAS.—*State Treasurer* may be relieved by depositing funds in depositories to be designated by him with consent and approval of the Governor and Attorney-General, one depository to be designated in each senatorial district and the maximum deposit to be $50,000 and bond with sureties to be given for one and one-half times maximum deposit. Act 430 of 1909.

County Treasurers in Baxter, Carroll, Greene, Independence, Izard, Lonoke and Sharp Counties may be relieved by depositing county funds, including school funds, in depositories designated by the county court; depositories to give bond for an amount not less than the currency revenue for the preceding year. Act 208 of 1907 as amended by Act 258 of 1909.

County Treasurers in Benton, White (Act 113 of 1905), Madison, Washington, Woodruff, Randolph, Boone (Acts of 1907), Cleburne, Franklin, Logan, Marion, Montgomery, Sevier, Ouachita and Union Counties (Acts of 1913) may be relieved in substantially the same way.

Treasurer of St. Francis Levee District may be relieved in same way—the designation to be made by board of directors. (Act 146 of 1913.)

Treasurer of City of Fayetteville may be relieved in same way—designation to be made by City Council, (Act 309 of 1913.)

CALIFORNIA.—*State Treasurer* may be relieved by depositing funds in banks designated by him with the approval of the Gov-

be borne in mind that there are some so-called depository laws, which do not make it obligatory upon the

ernor and Comptroller, provided the banks place with Treasurer certain specified securities 10 per cent. in excess of the deposit, to be approved by Governor and Comptroller; and provided the deposit in any bank does not exceed 50 per cent. of its capital nor 10 per cent. of the total amount in the custody of the officer while there are other qualified banks. Acts 1907, Ch. 50.

Treasurers of Counties and Municipalities may be relieved in substantially the same way, securities to be approved by District Attorney of the county or City Attorney for the municipality. Acts 1907, Ch. 522.

FLORIDA.—*State Treasurer* may be relieved by depositing funds in banks designated by Governor, Comptroller, and Treasurer, provided the banks deposit with the Treasurer bonds of the United States, the bonds of the several states, and county and municipal bonds, to be approved by the Governor, Comptroller and Treasurer. Rev. St. of 1906, Secs. 132-137.

Sheriffs, Tax Collectors, County Treasurers, City Treasurers, Clerks of Courts, Receivers, and the *Treasurers* or other *agents of the State, or of the courts thereof may* deposit any moneys they may have in their custody with the banks which shall be designated by the Comptroller for that purpose and which shall give satisfactory security, by the deposit of bonds of the United States or of the State of Florida, or other satisfactory security. Rev. St., 1906, Sec. 2717.

Not being *required* to deposit funds in those banks, it is doubtful if officers would be relieved.

ILLINOIS.—*City, town or village treasurers* may be relieved by depositing money in banks designated by ordinance, provided a bond be required from the banks in such penal sum and with such security as the City Council or Board of Trustees shall direct, sufficient to save the corporation harmless from any loss. Rev. St., 1909, Ch. 24, Sec. 96, P. 353.

INDIANA.—*State Treasurer, County Treasurers, City Treasurers, Town Treasurers, Treasurers of the Boards of School Commissioners of school cities, Treasurers of Boards of School Trustees of school cities, Treasurers of Boards of Trustees of school towns and Township Trustees* may be relieved by depositing all funds in their custody in the depositories selected by the Board of Finance of the state, county, city, town, school city, school town, or township, as the case may be, provided the depositories give individual bonds 25 per cent. in excess of the deposit or surety company bond equal to the deposit, to be approved by the proper Board of Finance or deposit bonds of the United States, the State of Indiana, or of a county or counties of said State. Burns' Rev. Statutes, Secs. 7526-46.

KANSAS.—*State Treasurer* may be relieved by depositing funds in depositories selected by the board of treasury examiners, consisting of the Governor, Secretary of State and State Auditor, provided that no bank shall have on deposit more than 50 per cent. of its capital nor more than $100,000, and provided further that each depository deposits with the State Treasurer bonds of the United States, of the State of Kansas, or of some county, school district or municipality of the state equal to the amount of funds to be deposited. General Statutes, 1909, Secs. 8813-22.

County Treasurers may be relieved by depositing funds in depositories designated by the County Commissioners, provided the depositories give bond in a sum double the largest approximate amount to be deposited at any one time, if a personal bond; or equal to the deposit, if a surety company bond. Gen. St., 1909, Sec. 2163.

Treasurers of cities of the first-class (over 15,000 population) may be relieved by depositing funds in banks designated by the Mayor and Council, provided the banks give bond with surety, in a sum to be designated by the Council. Gen. St., 1909, Sec. 951.

Treasurers of cities of the second (2,000 to 15,000) *and third* (under 2,000) *class, the Treasurer of the Board of Education of cities of the second-class and the Treasurer of the School Board of any district in which there is a city of the third-class* may be relieved by depositing funds in a bank or banks designated by the Mayor and

officers to put the money in the designated banks, and, therefore, do not relieve them of their ordinary lia-

Councilmen, or in the case of school funds, by the Board of Education or School Board, as the case may be; provided the depositories give bond with individual sureties in a sum double the largest approximate amount that may be on deposit at any one time or a surety company bond equal to the largest amount. Gen. St., Sec. 851.

LOUISIANA.—*State Treasurer* may be relieved by depositing funds with the fiscal agents of the State (Wolff's Rev. Law, 1904, Sec. 3773), which are designated by the State Board of Liquidation. Wolff's Rev. Laws, 1904, P. 1772.

MICHIGAN.—*County Treasurers* may be relieved by depositing funds in banks designated by the Board of Supervisors, or the Board of County Auditors, in counties having a board of county auditors—such banks to give bond in an amount at least equal to the maximum amount to be deposited and with sureties to be approved by the board and the prosecuting attorney. Howell's Statutes, Secs. 1048-53.

Treasurers of cities of the fourth-class may be relieved by depositing all money in banks designated by the council; such banks to furnish a bond, as the council may require and approve. Howell's Statutes, Sec. 5555.

Treasurer of any incorporated village may be relieved by depositing all public money in depositories designated by the legislative body, such banks to give bond to be approved by the council in a sum equal to the maximum amount to be deposited; provided there be not deposited in any bank an amount in excess of its capital and surplus, nor more than $200,000. Howell's Statutes, Sec. 6355.

Township Treasurers may be relieved by depositing public money in depositories designated by the Township Board, said depositories to give bond to be approved by the board in an amount equal to the penalty of the bond furnished by the Treasurer, but Treasurer is liable for any loss occasioned by deposits in excess of the amount of the bond. Howell's Statutes, Sec 1408.

MINNESOTA.—*State Treasurer* may be relieved by depositing funds in banks designated by the Board of Deposit, provided the banks deposit securities or give bond: if personal sureties, in double the amount to be deposited; if corporate surety, equal the amount to be deposited. Gen. St., 1913, Secs. 93-99.

County Treasurer may be relieved by depositing funds in banks designated by the Board of Auditors, provided the banks deposit securities or give bond as in the case of state depositories. Gen. St., Secs. 847-57.

City Treasurers may be relieved by depositing funds in banks designated by the City or Common Council, provided no bank receives more than 25 per cent. of its capital and surplus and provided all banks give bond for double the amount likely to be received. Gen. St., Secs, 1391-96.

Town Treasurers may be relieved by depositing funds in a bank designated by the Town Board, provided a bond in double the amount of the deposit be given. Gen. St., Sec. 1142.

Village Treasurers may be relieved by depositing funds in banks designated by the council, provided the banks give bond in double the amount to be deposited. Gen. St., Sec. 1796.

Treasurers of Common and Independent School Districts may be relieved by depositing funds in banks designated by the School Board, the banks to give bond as in the case of state depositories. Gen. St., Secs. 2763-64.

MISSISSIPPI.—*State Treasurer* may be relieved by depositing funds in depositories designated by the Governor, the Attorney-General and himself annually on the first of February—the depositories to place with the Treasurer certain named securities or bonds of a surety company in a sum 10 per cent. in excess of the amount the depository is authorized to receive; and no bank is authorized to receive more than 35 per cent. of the amount for which the bank was assessed for State taxes the preceding year. Laws, 1908, Ch. 96, as amended by Laws, 1910, Ch. 224.

bility. These laws have not been referred to in the note.

County Treasurers may be relieved by depositing funds, including funds of any drainage district, in banks designated by the Board of Supervisors annually in November, the depositories to place with the Treasurer securities or a surety company bond for a sum 10 per cent. in excess of the maximum deposit. Acts 1910, Ch. 137.

City and Town Treasurers may be relieved by depositing all funds in banks designated by Mayor and Alderman or other municipal authorities, in the same manner, and subject to same conditions as provided in the case of county depositories. Acts 1910, Ch. 138.

Treasurer of the Board of Commissioners for the Yazoo Mississippi Delta may be relieved by depositing all funds in banks designated by the commissioners; the banks to be designated for term of two years and to deposit securities equal to 50 per cent. of the estimated maximum deposit and bond with sureties equal to 75 per cent. Acts 1908, Ch. 97.

MISSOURI.—*State Treasurer* may be relieved by depositing all funds in depositories selected by him, with the approval of the Governor and Attorney-General, after advertisement, the banks to deposit with Treasurer securities equal to the amount on deposit and in addition a bond with sureties equal to 25 per cent. of the deposit, all to be approved by the Governor and Attorney-General. R. S., 1909, Secs. 11876-85.

County Treasurers may be relieved by depositing county funds, including school funds, in banks designated by the county court biennially,—the banks to give bond with surety to be approved by the County Court. Rev. St. 1909—Secs. 3803-17.

Treasurers of Cities of 350,000 *or more* may be relieved by depositing all funds in banks selected annually by Mayor, Comptroller and Treasurer,—the banks to give bond with surety for $500,000; and if deposit exceeds that amount, additional bonds to be given, but not more than one million dollars to be deposited in any one bank. R. S. Sec. 9858.

Treasurers of Cities of the first class (100,000 *or more*) may be relieved by depositing all funds in banks designated by the Common Council biennally after advertisement,—the banks to give bond in double the highest estimated amount of deposits during any month. R. S. Sec. 8585.

Treasurers of Cities of the second class (30,000 *to* 100,000) may be relieved by depositing all funds in a bank designated by the City Council biennally after advertisement, the banks to give bond equal to the estimated revenues for the current fiscal year. Secs. 107-9, of an Act approved March 25th, 1913. P. 469-70.

Treasurers of Cities of the third class (3,000 *to* 30,000) may be relieved by depositing all funds in a bank selected by the City Council in July of each year,—the bank to give bond at least double the revenues of the city for the year. R. S. Secs. 9217-19.

Treasurers of Cities of the fourth class (500 *to* 3,000) may be relieved by depositing funds in a bank designated by the Board of Alderman "for such length of time and under such rules and regulations as may be prescribed by ordinance." Acts, 1911, p. 341.

Treasurers of Eleemosynary, Educational or Penal Institutions may be relieved by depositing funds in banks selected by the Board of Managers,—the banks to give bond equal to the largest amount to be on hand to be fixed by the board. Acts 1911, p. 116.

Treasurers of Boards of Tuberculosis Hospital Commissioners may be relieved by depositing all funds in a bank annually selected by the board. Acts 1911, p. 131.

MONTANA.—*State Treasurer* to deposit all funds in banks to be designated by him, banks to give security to be approved by State Board of Examiners. Doubtful if Treasurer relieved. Rev. Codes, 1907, Sec. 183.

County Treasurers may be relieved by depositing funds in banks designated by County Commissioners, the banks to give securities or indemnifying bonds to be approved by County Commissioners. Rev. Codes. 1907, Sec. 3003, as amended by Ch. 88 of Acts 1913.

City and Town Treasurers may be relieved by depositing funds in banks selected by the Council, banks to give such security or indemni-

If there is no law which provides public depositories and relieves the officer of depository liability, or if

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fying bonds as Council may approve. Sec. 3257 of Code, 1907, as amended by Ch. 88 of Acts of 1913.

NEBRASKA.—*State Treasurer* may be relieved by depositing all funds in banks, which shall give bond to be approved by the Governor, Secretary of State and Attorney-General, but the Treasurer is not to have on deposit in any bank more than the amount of the bond, if the surety is a corporation, nor more than half the amount of the bond, if the sureties are individuals, nor more, in any event, than 30 per cent. of the bank's capital stock. In lieu of bonds with surety, the banks may deposit certain securities named in the statute. Cobbeys Anno. St. 1911. Secs. 11364-68.

County Treasurers may be relieved in the same way except that Treasurers may deposit in any one bank an amount equal to 50 per cent. of its capital. Bonds or securities to be approved by the County Board. Cobbeys Anno. St. Secs. 11369-74.

Treasurers of Cities of 5,000 *to* 25,000 may be relieved by depositing all funds in banks, which shall give bond to be approved by the Mayor and filed with the Clerk; but the Treasurer is not to deposit in any one bank more than one half of the amount of the bond nor more than 20 per cent. of the bank's capital. Cobbeys Anno. St. Secs. 8637-39.

Treasurers of Cities of 25,000 *to* 40,000 may be relieved by depositing all funds in banks designated by the Council, the banks to give bond to be approved by the Mayor and Council; but no such deposit is to be made in any bank with a capital of less $50,000 nor for more than 50 per cent. of the capital and surplus, nor for more than the amount of the bond. Cobbeys Anno. St. Sec. 8245.

Note.—The depositors guaranty law (Act, 1909, Ch. 10, as amended by Act, 1911,) provides that no bank which has complied in full with all the provisions of the Act shall be required to give any further security or bond for the purpose of becoming a depository for any public funds, but public funds shall be secured in the same manner that private funds are secured. Cobbeys Anno. St. 3746.

In State vs. Havelone, 139 N. W., 636, it was held that this Act repealed so much of the provisions of the state depository law as required the giving of bonds to secure the deposits; and that any state bank could demand its share of state funds without giving the bonds required by the depository law. It would seem therefore to be unnecessary to the protection of the several classes of public officers that state banks give the bonds provided for by the depository law. In other respects the law must be complied with.

NEW JERSEY.—*Any County, City or other Municipality* is authorized to select as a depository for its money any bank having its place of business in New Jersey. Comp. St. 1910, p. 3670, Sec. 744 (P. L., 1910, p. 64). If bank selected by proper authority and officers directed to deposit funds therein, they would no doubt be relieved of personal liability. See also Comp. St. Sec. 2289, (p. 1245), which provides that City Treasurers shall deposit funds "as and when required by the City Council in such banks and trust companies as it may designate"

Board of Sinking Fund Commissioners of any City may be relieved by depositing funds in such banks as the City Council may prescribe and the Mayor in writing approve. Comp. St. Sec. 2293, p. 1247. (P. L. 1908, p. 498).

Borough Collectors may be relieved by depositing funds in banks designated by the Council, the deposits to be made in the corporate name of the borough. Comp. St. Secs. 18-19, p. 235.

County Clerks may be relieved by depositing funds in banks designated by the Justice of the Supreme Court holding in the circuit. Comp. St., p. 1522.

NEW YORK.—*State Treasurer* may be relieved by depositing funds in such banks as in the opinion of the Comptroller and Treasurer are secure and pay the highest rate of interest to the State,—the banks to give bond with surety or bonds of the State of New York to be approved by Comptroller and Treasurer. State Finance Law, Sec. 8.

the law which exists has not been strictly complied with, the surety should require the officer to demand

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State officers, except Treasurer, may be relieved by depository funds in banks designated by the Comptroller, the banks to give security to be approved by Comptroller. State Finance Law, Sec. 10.

Treasurer of any Charitable or Benevolent Institution may be relieved, as to money received from the State, by depositing it in banks designated by the Comptroller, the banks to give security to be approved by him. State Finance Law, Sec. 11.

Treasurers of Cities of the second class (50,000 *to* 175,000) may be relieved by depositing funds to the credit of the city in banks designated by the Board of Estimate and Apportionment. Second Class Cities law Secs. 69, 70.

Town Supervisors may, at the expense of the town, procure depository bonds for the protection of town funds. Town Law, Sec. 101.

Treasurers of Towns of 3,000 *or over in a County of* 300,000, *or over,* and adjoining a city of 250,000 or over, may be relieved by depositing funds in banks, if any, designated by the Town Board, provided the banks give such security as the board may require. Town Law, Sec. 510.

Village Treasurers may be relieved by depositing funds in banks, if any, designated by the Board of Trustees, provided the banks give such security as may be required by the board. Village Law, Sec. 89, Sub-Sec. 20.

OKLAHOMA.—*State Treasurer* directed to deposit funds in banks designated by him, with the consent of the Governor and Attorney-General,— the banks to deposit securities, (and not bond with surety), to be approved by the Governor, Attorney-General and Treasurer, equal to amount on deposit, but the amount on deposit at one time shall not exceed the capital of the bank. Comp. Laws, 1909, Secs. 7409-10. Doubtful if Treasurer relieved.

County Treasurers may be relieved by depositing funds in banks designated by the County Commissioners as county depositories,—the banks to give bond in a Surety Company in a sum equal to the deposits, or in lieu thereof, may deposit securities; but the deposits shall not exceed the capital of the bank. Comp. Laws, 1909, Sec. 1817.

Note.—Probably necessary to give security notwithstanding depositors guaranty law of 1907 and 1909. See Sec. 327, Comp. St. 1909. See also Sec. 328. But if security not given public officers, like private individuals, would receive the benefit of this fund.

OHIO.—*State Treasurer* may be relieved by depositing funds in banks designated by the State Board of deposit; provided he does not deposit in any bank an amount in excess of its capital, nor in excess of $300,000, and provided the banks deposit securities equal to the deposit, or bonds with Corporate Surety 5 per cent. in excess of deposit. Page & Adams Code, Secs. 324 to 330-8.

County Treasurers may be relieved by depositing funds in banks designated by County Commissioners for three years, provided the banks give bonds or securities to be approved by the board equal to the deposit. P. & A. Code, Secs. 2715-41.

Treasurers of Cities and Villages may be relieved by depositing funds in banks, if any, designated by the Council, provided the banks give bond or furnish securities to be approved by the proper municipal officers, in a sum 10 per cent. in excess of deposit, and provided the deposit does not exceed the capital and surplus of the bank nor exceed one million dollars. P. & A. Code, Sec. 4295.

Trustees of Sinking Fund of Cities and Villages may be relieved by depositing funds in banks selected by them, provided they exercise due care and require the banks to give bond, with corporate surety, equal to deposit, or bond with personal sureties 20 per cent. in excess of deposit and provided the deposit is not in excess of the capital and surplus of the bank or in excess of $400,000. P. & A. Code, Sec. 4515-16.

Township Treasurers may be relieved by depositing funds in banks designated by township trustees, provided no deposit be made in excess of $300,000 and provided banks give bond equal to the deposit. P. & A. Code, Secs. 3320-26.

of the banks, in which he will deposit the funds under his control, a bond, with an acceptable corporate surety

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Treasurer Board of Education of School Districts may be relieved by depositing funds in banks designated by the school board, provided the banks give bond or securities to be approved by the board and provided the deposit in any bank is not in excess of its capital nor in excess of the amount of the bond or securities. P. & A. Code, Secs. 7604-9.

OREGON.—*State Treasurer* may be relieved by depositing funds in banks designated by him annually, provided the banks give bond to the State with corporative surety, or deposit with the Treasurer securities, equal to the deposit. Lord's Oregon Laws, Secs. 2639-48.

County Treasurers may be relieved in substantially the same way. Acts 1913, Ch. 273, p. 515.

County Treasurer, Multonah County, may be relieved in substantially the same way. Acts 1913, Ch. 333, p. 651.

PENNSYLVANIA.—*Treasurer of Counties of* 750,000 *to* 1,200,000, may be relieved by depositing funds in banks designated by a board composed of County Commissioners, Comptroller and Treasurer, the banks to have a capital and surplus of not less than $500,000 and to give bond to be approved by the County Commissioners. 5 Purdons Dig. (13th ed.), p. 5363. Act 1 Apr., 1909, P. L. 93.

Treasurer of School Districts may be relieved by depositing funds in banks (if any) designated by the Board of School Directors as school depositories. Purdons Dig. (13th ed.), Supp., 1912, p. 81.

SOUTH CAROLINA.—*State Treasurer* directed to deposit funds in such banks as shall be agreed upon by Governor, Comptroller-General, and Treasurer, or any two of them. No security required by law and not clear that Treasurer would be relieved in case of bank failure. Civil Code, 1912, Sec. 792.

County Treasurers directed to deposit certain funds in banks selected by them and to require the banks to give a "depositors guaranty bond." Selection being made by Treasurer, he is probably not relieved in case of bank failure. Civil Code, 1912, Sec. 451.

SOUTH DAKOTA.—*State Treasurer* may be relieved by depositing funds in banks designated by State Board of Finance, provided he does not deposit in any bank more than 40 per cent. of its capital and surplus and provided the banks give bond: if individual sureties double the deposit; if corporate surety, equal to the deposit. Laws 1909, Ch. 229; Pol. Code, 1913, p. 90: Laws 1911, Ch. 234; Pol. Code, p. 90d.

County Treasurers may be relieved by depositing all funds in banks designated by County Commissioners, provided the banks give bond as in the case of state depositories. Pol. Code 1913, p. 90h to 92, Laws 1913, Ch. 360.

TENNESSEE.—*State Treasurer* directed to deposit all funds in such bank or banks, as in the opinion of the Comptroller and Treasurer shall be secure, but he shall not deposit in any bank more than one-fourth its capital Code of 1896. Sec. 278-81.

Any bank in Tennessee may become a public depository of revenues belonging to the State by giving bond according to law for the safe keeping of the revenues deposited with it. Code, Sec. 970. Doubtful if compliance with these provisions would relieve Treasurer.

County Trustees may be relieved by depositing funds in depositories designated by the Finance Committee, the depositories to execute "good and sufficient bond" to be approved by the committee. Acts 1909, Ch. 305, p. 1115.

VIRGINIA.—*State Treasurer* may be relieved by depositing funds in banks named in the statute; but before any such deposit is to be made, banks must each give bond or furnish securities for $500,000 to be approved by the Governor. Pollard's Code of 1904. Sec. 753, as amended and found in Supp., 1910.

Treasurers of any County or City may be relieved by depositing all funds held for school purposes in such depository as the School Board may designate, provided the depository gives bond to be approved by the County or Corporation Court. Pollard's Code, 1904. Sec. 1506a.

Clerk and other officers of State Corporation Commission may be relieved by depositing all funds in a state depository designated by the Commission. Pollard's Code, Sec. 1313a.

in favor of the officer and his surety, conditioned for the safe keeping and proper payment of the funds on demand. It is not considered good policy for a surety

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Treasurer Virginia Normal and Industrial Institute may be relieved by depositing all funds in banks designated by the Board of Visitors,—the banks to give bond in double the amount of the deposit. Pollard's Code of 1904, Sec. 1613cl. 11.

WASHINGTON.—*State Treasurer* may be relieved by depositing funds in state depositories designated by Board of Finance, provided the amount on deposit at one time does not exceed the capital and surplus of the bank, nor the amount of the bond with corporate surety which is required nor three-fourths of the value of the securities deposited in lieu of the bond. Rem. & Bal. Code 1910, Secs. 5065-77.

County Treasurers directed to designate depositories for county funds, the depositories to give bond with corporate surety or deposit securities equal to the deposit, but the treasurers are not relieved. R. & B. Code 1910, Secs. 5072-76.

City Treasurers in cities over 75,000 authorized to deposit all funds in banks selected by them with the approval of the mayor, the banks to give corporate bond or securities equal to the deposit to be approved by the Mayor and Comptroller but it is not clear that the Treasurer is relieved R. & B. Code 1910, Secs. 5078-80.

City Treasurers in cities less than 75,000 have same authority. R. & B. Code 1910, Secs. 5081-83.

WEST VIRGINIA.—*State Treasurer* may be relieved by depositing funds in banks designated by Board of Public Works, the banks to have a capital of not less than $20,000 and to give bond for not less than $50,000 (to be renewed every two years); and the deposit to be not more than three-fourths of the penalty of the bond. Code 1913, Secs. 750 and 3067.

Custodian of Sinking Fund of any County, District, School District, Independent School District, City, Town or Village may be relieved by investing the sinking fund in the manner provided, or if there are no securities available, by depositing the funds in banks designated by the County Court, Board of Education or Common Council, as the case may be, as county or city depositories; the banks to give good and sufficient bond to be approved by designating authority, in a sum double the amount to be deposited. Code 1913, Secs. 2498.

WISCONSIN.—*State Treasurer* may be relieved by depositing all funds in State depositories designated for term of four years by State Board of Deposits, but deposit is not to exceed bank's capital; the banks to give bond: if with personal sureties, double the deposit; if with corporate surety, 50 per cent. in excess, to be approved by the board. Statutes 1911, Secs. 160a to 160d.

County Treasurers may be relieved by depositing all funds in depositories designated by the County Board,—the banks to give bond to be approved by the board for not less than the amount of the deposits Statutes 1911 Secs. 693 and 717.

City Treasurers may be relieved by depositing all funds in banks in Wisconsin designated by resolution of the Council, such banks to give bond to be approved by the Mayor and Comptroller. St. 1911, Secs. 925-127.

WYOMING.—*State Treasurer* may be relieved by depositing funds in depositories designated by the State Board of Deposits annually, provided he does not deposit in any bank more than one-half its capital and surplus and provided the banks give bond with corporate surety or deposit securities, equal to deposit. Comp. St. 1910, Secs. 2486-91.

County Treasurers, City Treasurers, Town Trustees and Treasurers of School Districts may be relieved, if they exercise reasonable care, by depositing funds in banks designated by the proper governing board, provided the banks give bonds or deposit securities to be approved by the board; but the Treasurer is not to deposit in any bank more than half the penalty of the bond, if with individual sureties, nor more than 90 per cent. of securities or bond with corporate sureties nor more than half the capital and surplus of the bank. Comp. St. 1910, Secs. 2499-2506.

company to carry the depository liability on a public officer without being compensated therefor, or obtaining adequate protection, in the manner above indicated; and in order to avoid carrying too much liability in one place, it is advisable to let some other company carry the depository liability.

Sec. 36.—**Defaults by Subordinates.** For the same reason that an officer, unless specially relieved, is held liable for a loss resulting from the failure of a bank in which he has deposited public money,[1] he is also held liable for a loss resulting from a default on the part of his deputies or clerks. In some cases, the deputies and clerks are themselves required by law to give bond for the protection of the state, county or city, as the case may be, and that would indicate that the officer would not be held liable for a default on their part. But, where they are not required by law to give bond, and where the officer is liable for their defaults, he should require them to give regular fidelity bonds, so as to protect him and his surety from that liability. A surety company cannot afford, for one premium, to assume a risk of default by more than one person.[2]

Sec. 37.—**Loss by Burglary, Theft or Larceny.** A public officer ordinarily would not be relieved of his duty to account for money that had come into his hands, by the fact that it had been taken from his custody by a third person. While it is bad judgment for an officer to keep any substantial amount of public money on hand, yet it may sometimes be unavoidable.

[1]See Section 35.
[2]See Section 1.

In that event, the money should be kept in a good safe; and he and his surety should be further protected by burglary insurance on the safe. The premium for the officer's bond does not compensate for this risk; and where the applicant declines to comply with the surety's requirement in this respect, the bond should not be written, unless the financial resources of the applicant are deemed sufficient to take care of any probable loss from this cause.

Sec. 38.—**Liability for Interest Derived from Public Funds.** It seems to have been quite the custom, a few years ago, for public officers to appropriate to their own use the interest earned on public funds; and it appears to have been considered proper in many cases. But now the courts hold that a public officer is required to account for any interest that he may receive on loans or deposits of public money. It is important therefore to ascertain that an applicant for a public official bond does not consider this a legitimate subject of "graft," but that he recognizes his obligation to account for any money that may be received from this source. Unless proper provision is made by which the public will receive the interest, the bond should not be written in the absence of adequate financial responsibility on the part of the applicant. The fact that the use of the interest by the incumbent of the particular office may have been acquiesced in by the public for a long time is not sufficient to justify its continuance; for there are cases on record where the surety for a public officer has been called on to make good the interest on public funds received and

used by the officer; and this, notwithstanding the fact that the officer had long since retired from the office and the use of the interest by him had been apparently considered proper by those who at the time were aware of it.

Sec. 39.—**Neglect or Malfeasance of Official Duty.** We have been considering public official bonds from the standpoint of the liability of the surety for public money that comes into the hands of the officer. But the surety is liable also for the failure of the officer to perform his duties or for the improper performance of them, although of course there can be no recovery against the surety unless the neglect or malfeasance of the principal results in financial loss either to the state, county or city, or to some third person who has a right to demand the proper performance of duty by the officer.

The best illustration of the possibilities of loss from neglect or malfeasance is furnished by tax collectors. As a rule, a tax collector is furnished, at the beginning of the fiscal year, with the tax roll and is required, within a certain time either to collect the taxes listed on the roll or make a satisfactory explanation of his failure to do so. In some states, his mere affidavit to the effect that the taxes are uncollectible will be accepted, and on such affidavit he will be relieved from liability. In other states, his statement of uncollectible taxes is subject to review by another officer, and if the other officer is of the opinion that some of the uncollected taxes, by the exercise of due diligence, might have been collected, or if he thinks the collector has

not used all the means provided for by law for making the collections, then the collector will be charged with, and required to pay, the amount so found to be collectible. It is evident that a surety company should not take any such risk; so that unless the collector can be relieved of liability for uncollected taxes by making an affidavit that the uncollected taxes are uncollectible, or by other similar means, the bond is not a legitimate surety proposition and should be declined, unless perhaps the applicant is very strong financially—worth, say, an amount equal to the penalty of the bond. In determining how the collector is to be relieved of liability for uncollected taxes, it is not safe to rely upon custom not supported by law, for a change in the political complexion of the administration very often brings about a change in such customs.

Another illustration of the possibilities of loss from neglect or malfeasance is afforded by clerks of courts, recorders of deeds, and the like. If such an officer, or any of his clerks, should inadvertently fail to enter a judgment or to record a legal paper, or should do so erroneously, and such error should result in loss to a third person, the officer and his surety would be liable for such loss. Such bonds should not be written unless the applicant is an intelligent man and is familiar with that character of work. Bonds of this kind cannot safely be written for men who, though honest, have not the experience and training that will enable them to do the work successfully. In large offices, where an experienced deputy is to be in active charge of the work, this point is not so important, but the principal danger

lies in small offices, where the officer himself is to be in active charge of the work, and where, by political influence, an ignorant man or one with little or no clerical experience is elected or appointed to fill the office.

Without attempting to go into this point in further detail, it may be said in general that wherever an officer is required by law to perform duties, the neglect or improper performance of which will likely result in financial loss either to the state, county or city, or to a third person who has a right to demand and expect the proper performance of duty by the officer, the risk of the surety is more than an honesty risk and partakes of the nature of a financial guarantee. Such bonds should not be written unless the applicant is thoroughly familiar with the character of work he will be called upon to do. If there is any reasonable doubt on this point, a fair amount of financial responsibility is requisite,—an amount equal to one fourth the penalty of the bond.

Sec. 40.—**Acts in Excess of Authority.** Another way by which a public officer may impose a liability on his surety without misappropriating any money is by exceeding or abusing the authority conferred upon him by law. However, an official bond is not regarded as imposing a liability on the surety for the purely personal acts of the officer not done as a part of, or in connection with, his official duty, as, for example, the receipt of money which it was not the officer's duty to receive, or the arrest of an individual, or the seizure of property, without a warrant. But in most states, acts done under color of the office are regarded as acts

for which the sureties are liable. Thus, the surety is liable, where an officer, having an execution, seizes the goods of one person when the execution is directed to another; or having a warrant, arrests the wrong person.

United States marshals, sheriffs and constables, whose duties include the service of process of the courts, are the chief offenders in this respect; and before executing bonds of this class, it should be ascertained that the applicant has sufficient intelligence, knowledge and discretion to keep within the limit, or sufficient money or property to take care of his mistakes. It is not necessary that an officer take any risk, as in questionable cases, he can decline to execute the process or require a bond to indemnify him against loss.

United States marshals are appointed by the President and are generally men of good standing and are able to keep within their rights. In cases of doubt, they can consult the district attorney; and in many offices, there is a chief deputy who has been holding from term to term, who is thoroughly conversant with the rights and duties of a marshal. As a rule, a United States Marshal is a good risk without regard to his financial responsibility.

The same general observations might be made with regard to sheriffs in large cities and counties; and there is little danger that a sheriff of this class will exceed his authority to the extent of imposing a liability on himself or his surety. Nearly all losses on sheriff's bonds occur in the country districts where the sheriff

is likely to be unfamiliar with legal process, and the extent of his powers; where he personally does the work; where there is no attorney to advise him; where the only compensation is in the shape of fees; and where, in order to make a fee, he will sometimes "take a chance." Sheriffs of this class should not be bonded unless their experience and training are such as to reasonably qualify them for the office, or unless they have some property subject to execution. If they will lose anything by acts in excess of authority, they are likely to keep within the limit.

The same remarks would apply to deputy sheriffs and others who personally execute the process in the larger offices. However these men are as a rule under the close supervision of their chief, who can generally keep them straight, and the risk is not considered particularly great, and financial responsibility is not absolutely necessary, although of course desirable. It often happens, however, that in cases of strikes or other disturbances, a large number of special deputies are sworn in for the purpose of maintaining order. These men are paid by the employer, and, generally "go the limit" in enforcing his orders. Where the feeling is tense between the employer and employees, and where the strikers are a rough class of men, such, for example, as miners, the risk is generally bad, and the application should be declined.

Constables, or city marshals, as they are called in New York City, and some other places, are bad risks and are rightfully on the prohibited list of surety companies. In the first place, a constable is generally

a low order of politician with little or no money and less brains, and who, having been unable to get any other position, accepts that of constable as a last resort. In the second place, constables are given the undesirable collections of loan sharks, instalment houses and the like, and being hard up for fees and having nothing to lose, will generally make seizures regardless of consequences, as long as they get the fee. The surety on such a bond is in constant danger of damage suits.

CHAPTER III.

Court Bonds—Fiduciaries.

Sec. 41.—In the language of surety companies, a fiduciary is one who, under the jurisdiction and supervision of a court of justice, has the care and custody of another's property, holding it in trust. The term includes executors and administrators of estates of deceased persons, trustees, receivers, assignees for the benefit of creditors, guardians and tutors of minors, and committees and conservators of the estates of incompetents. Fiduciaries are always required to give bond with surety for the faithful performance of their duties; and these bonds form one of the most important branches of the surety business.

It seems advisable, before beginning a discussion of the underwriting of these bonds, to define, briefly and in a general way, the duties of each of the different classes of fiduciaries, so that the discussion may be the more intelligible.

Sec. 42.—**Executors and Administrators.** An executor is a person appointed by a will to administer the estate of a testator,—to pay his debts and distribute the assets as directed by the will. An administrator is a person appointed by a court having jurisdiction over estates of deceased persons to perform the same functions with respect to the estate of a person who has died without leaving a will; the distribution, in that event, being made as directed by law.

It is the duty of an executor or administrator immediately to take charge of the assets and give notice

by publication, in the manner required by law, of his appointment, so that those who have claims against the estate may have an opportunity to present them to the court to be approved and allowed. As soon as practicable, he ought to file with the court an inventory of the assets; and, when the statutory period within which claims may be filed, has expired, he ought, unless the estate is involved in litigation, or he is otherwise delayed, to pay the debts and distribute the balance of the estate to those entitled to receive it. The identical assets may be distributed where practicable; but, if necessary, the executor may, under proper order of the court, sell them and distribute the proceeds.[1]

Although it is the duty of an executor or administrator, as soon as practicable, to distribute the estate, and not to hold and invest it; yet, if there should be a necessary delay in winding up the estate, he ought to use reasonable diligence to have the estate yield an income.[2]

An executor is not expected to continue a business left by the decedent, unless specially authorized to do so by the will; and if he does so, and loses any part of the assets, he and his surety will be liable. Likewise, an administrator ought not to continue a business unless authorized to do so by the court; and then only when the court has specific statutory authority to make the order.[3]

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[1]See Section 69.
[2]See Section 64.
[3]See Section 62, and for a more complete discussion of the duties and liabilities of executors and administrators see Sections 54-74.

Sec. 43.—**Administrators De Bonis Non.** Where an administrator dies, resigns, or is discharged before the administration is complete, it is the duty of the probate court to appoint a successor, who is called an administrator de bonis non. It is his duty to complete the administration in the same way as the first administrator would have been required to do.[1]

Sec. 44.—**Administrators Cum Testamento Annexo.** Where a man leaves a will but does not name an executor, it is the duty of the court to appoint some one to administer the estate. Such a one is called an administrator with the will annexed (cum testamento annexo, or c. t. a.). His duties are the same as if he had been named in the will.[2]

Sec. 45.—**Administrators Cum Testamento Annexo De Bonis Non.** Where an executor dies, resigns or is discharged before the administration is complete, it is the duty of the probate court to appoint a successor, known as the administrator with the will annexed de bonis non, (cum testamento annexo de bonis non or c. t. a. d. b. n.). It is the duty of such an administrator to complete the administration in the same way as the executor would have been required to do,—paying the debt and carrying out the provisions of the will.[3]

Sec. 46.—**Temporary or Special Administrators or Administrators Pendente Lite.** When a will is offered for probate, and its validity is contested, the person named in the will as executor will not be permitted to

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[1] See Section 42 and Sections 54-74.
[2] See Section 42 and Sections 54-74.
[3] See Section 42 and Sections 54-74.

qualify as such until it has been decided that the will is valid. In the meantime, the court will appoint some one to preserve the estate. And where, in a case of intestacy, there is a contest as to who is entitled to be appointed administrator, or where there is any other reason why a regular or permanent administrator cannot be appointed, the court will likewise appoint some one to look after and preserve the estate. Such an appointee is known as a temporary or special administrator or an administrator *Pendente Lite* depending upon the language of the statute regulating the matter or the usage in the particular State. The duty of such an administrator is merely to preserve the estate. The Court may authorize him to convert into money any part of the estate which may be perishable or which is likely to depreciate in value. But generally he has no right to pay any debts or to distribute any of the assets or to carry on any business that may have been left by the decedent. His duties are simply to preserve the estate pending final decision as to the validity of the will or as to who is entitled to be administrator.[1]

Sec. 47.—**Trustees.** Any person who holds property in trust for another is a trustee. In that sense, trustee has the same meaning that we have given to the word fiduciary. In the language of surety companies, trustee is used in a more restricted sense, including only trustees strictly so called. Indeed, it is generally limited to trustees of express trusts, that is

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[1] See Section 42 and Sections 54-74.

to say, trusts created by an instrument in writing, such as a deed, or will; and furthermore, it is limited to such trustees of express trusts as administer their trusts under the jurisdiction of a court of chancery.

The first and most important duty of such a trustee is to study and become thoroughly familiar with the provisions of the instrument, and thereafter to follow them out explicitly. In cases where there are no directions in the instrument, or where the directions are ambiguous, uncertain, or incomplete, he ought to apply to the court for directions. In this connection, it is to be remembered that a court of chancery is a court of general jurisdiction; and that a grant of authority from such a court, unless appealed from and reversed, will generally protect the trustee and his surety from liability for any loss that may result.[1]

Sec. 48.—**Trustees, Commissioners, Guardians and Administrators to Sell Property.** When a court of chancery orders the sale of real estate or personal property, it is usual, and indeed necessary, to appoint a trustee, or commissioner to make the sale. It is the duty of such appointee to sell the property either at public or private sale, as may have been ordered, and upon the terms fixed by the decree. He is then to apply the proceeds in accordance with the orders of the court,—either investing them or distributing them to the proper persons. The same duties are incumbent upon an administrator, a guardian or other fiduciary, who may be authorized by a court to make sale of real estate or per-

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[1]See Sections 54-74.

sonal property. In all such cases it is important that the sale be made to a third person, in good faith, for the best price that can be obtained and in the manner and upon the terms fixed by the order. The proper disposition of the proceeds will depend upon the order of the court, and it should be strictly followed.[1]

Sec. 49.—**Receivers.** A receiver is an officer of a court of chancery, through whom the court, in the exercise of its jurisdiction, takes possession of property which is the subject of a suit, preserves it from spoliation, waste or destruction, and ultimately disposes of it according to the rights of those entitled thereto. The most frequent occasion for the appointment of a receiver is for a business which is insolvent and where the assets are in danger of spoliation or waste.

The purpose of the appointment, however, is not necessarily at once to wind up the business and distribute the assets to the creditors, but the receiver may be authorized by the court to continue the business. Being a court of general jurisdiction, its order to continue the business will be a complete protection to the receiver, even though a loss should be the result; provided, of course, the receiver exercises reasonable care and diligence to make the business successful, complies with all the orders of the court and makes the required reports to the court from time to time while the business is being conducted. The receivership will be terminated finally by paying all the debts and restoring the property to the original owners, or selling it and distributing the proceeds to the creditors.[1]

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[1]See Sections 54-74.

Sec. 50.—**Receivers and Trustees in Bankruptcy.** When, under the national bankruptcy law, a man is adjudicated a bankrupt by the United States District Court (and sometimes before he is so adjudicated), it is the duty of the court to appoint a receiver to take charge of the assets of the bankrupt. The duty of the receiver is merely to hold the assets intact pending the election by the creditors of a trustee; although the receiver may be authorized to convert into money any assets that may be of a perishable nature. The duty of the trustee is to convert the estate into money and distribute it to the creditors, being governed in all matters by the terms of the bankruptcy law and the order of the court.[1]

Sec. 51.—**Assignees for the Benefit of Creditors.** A person who is unable to pay his debts may file his petition in bankruptcy, give up all, or practically all, of his property, and, in a proper case, get a discharge from all his debts. This is the usual practice, but there are cases where the insolvent debtor prefers to make an assignment for the benefit of creditors; that is, convey all his property to a third person, with directions to convert it into money, and after paying expenses, to divide it among the creditors. The grantee in such a conveyance is known as an assignee for the benefit of creditors. It is his duty to administer the trust in the manner pointed out in the deed of assignment; and in order that he and his surety may be protected, as far as possible, from the consequence of

[1] See Sections 54-74.

his errors, he ought to submit himself and the estate to the jurisdiction of a Court of Chancery and obtain its directions in all matters pertaining to the administration of the trust. If he does not do so, he and his surety not only take the risk of errors, but the assignee will not be required to file periodical accounts nor can the surety obtain a statutory release nor will the surety have any of the other rights and remedies in such cases provided. Consequently the risk of the surety is greatly increased by an administration independent of a Court of Chancery.

There is still another danger to which an assignee and his surety are subject. The making of an assignment for the benefit of creditors is in itself an act of bankruptcy; that is to say, it gives the creditors the right to have the assignor adjudicated a bankrupt and to have the estate administered by the United States District Court, which is the bankruptcy court. If after an assigned estate has been partially administered, the assignor should be thrown into bankruptcy, the trustee in bankruptcy would be entitled to the entire estate, just as it existed at the time of the assignment, and would of course be bound to distribute it in accordance with the bankruptcy law. If therefore, the assignee had disposed of the estate, or any part of it, contrary to the provisions of the bankruptcy law, even though in accordance with the state law governing assigned estates, he and his surety would be bound to make good the portion thus improperly distributed.

This is not merely a theoretical danger, for one of the companies sustained a single loss of over $17,000.00

from this cause. In this connection, it may be well to note that assignments of this kind are made, as a rule, only where the assignee wants to give some special preference that would be contrary to the bankruptcy law, or obtain for himself some advantage that would not be permissible under that law. Any such preference or advantage would necessarily be to the disadvantage of the general creditors and therefore it is quite probable that the assignor will be put into bankruptcy; and a surety should not, as a rule, sign these bonds unless the applicant has a very considerable amount of property.[1]

Sec. 52.—**Guardians and Tutors of Minors.** A guardian is the person appointed by a probate court to manage the estate of a minor, the latter being known as the ward. In Louisiana, the person who manages the estate of a minor is called a tutor. It is the duty of the guardian or tutor to take charge of the estate and keep it invested, in the manner provided by law and the orders of the court, until the minor reaches his majority. It then becomes his duty to file a final account, turn over the estate to the ward, and obtain a release of himself and his surety. He should also, during the minority of the ward, file periodical accounts of his administration, as required by law. If it is necessary for the guardian to expend any part of the estate, either principal or income, for the maintenance or education of the ward, or for any other purpose, he should obtain an order of court authorizing

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[1]See Sections 54-74.

him to do so; otherwise he and his surety may be held liable for the money so expended. In some states the guardian has a discretion to use the income for the maintenance of the ward, but it is not the general rule; and unless the statutes expressly authorize the guardian to do so, the surety should not permit it.[1]

Sec. 53.—**Committee, Conservator or Curator.** An insane person, or person *non compos mentis,* has no status in law, and like a minor, cannot legally act with respect to his own property. It is therefore necessary for the courts to appoint some one to act for him. Such person is called a committee, in most of the states; although in Illinois, and some others, he is called conservator, and in Louisiana, he is called a curator. His duty is to manage the estate, under the order of the court, and keep it properly invested. He should file periodical accounts of his administration; and, if it becomes necessary to use any part of the estate for the maintenance of the incompetent, he should obtain an order of court authorizing him to do so.[1]

Sec. 54.—**The Underwriting of Bonds of Fiduciaries.** In the preceding pages, all of the important kinds of fiduciaries have been mentioned, and a brief sketch has been made of some of the duties and liabilities peculiar to each class. Consideration will now be given to the duties and liabilities which are common to nearly all fiduciaries and to the nature of the risk that will be assumed by the surety; and in the case of fidelity bonds, and bonds of public officers, the subject will be treated

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[1]See Sections 54-74.

from the two standpoints of the personality of the applicant, and the nature of the position.

Sec. 55.—**The Personality of the Applicant.** In the consideration of applications for bonds of fiduciaries, surety companies are confronted with the personal element in much the same way as with fidelity and public official applications. The duty of a fiduciary includes the custody and care of money and property of others, and it is necessary to be satisfied as to his probable honesty.

It is not feasible, however, as a rule, to investigate his antecedents, environment, character, habits and record of service to the same extent as with fidelity applications.[1] Generally the only sources of information are the applicant's attorney and the three or four persons to whom the applicant refers. In making an investigation through these sources, the underwriter will be governed by the same rules and principles as in the case of fidelity and public official applications.[2] However, in many cases an almost immediate decision is necessary, so that practically no opportunity to make an investigation is offered. Applicants will then have to be accepted or rejected on their general reputation and the statements of their attorneys; but this can safely be done only where the surety obtains joint control of the assets so that they cannot be misappropriated without the consent of the surety. Indeed, as we shall see it is getting to be the uniform practice of bonding com-

[1]See Sections 5-7.
[2]See Section 8.

panies to require all applicants for bonds of this kind, to give the surety joint control of the assets.[1]

Sec. 56.—**Personality—As Affected by Standing of His Attorney.** There are few, if any, cases in which fiduciaries can successfully perform their duties without the continuous aid and advice of an attorney; and they have a right, at the expense of the estate, to employ counsel to represent them. The character of an applicant can often be determined by the standing of his attorney; and furthermore, the character and standing of the attorney, and the extent of his control over the practical management of the estate are important considerations in judging the desirability of a particular risk. Where a careful attorney of well recognized ability and integrity has the actual management of the estate, the possibility of loss is greatly reduced. And where the applicant is not represented by an attorney of good standing, the business should be declined unless strict joint control is secured; and even then, it is not altogether desirable, as it is always unsatisfactory to deal with an attorney in whom one has not reasonable confidence.

Sec. 57.—**The Nature of the Position. In General.** The bond of a fiduciary is not, like a fidelity bond,[2] limited to cover only certain definite and specific acts of the principal; but, like the bond of a public officer,[3] is conditioned for the faithful performance of all his duties. The duties of the several kinds of fiduciaries

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1See Sections 58 and 72.
2See Section 2.
3See Section 21.

have in a general way been indicated, and some of the liabilities peculiar to each class have been pointed out.[1] It is next in order to consider the duties and the liabilities, which are common to nearly all fiduciaries, and to which they and their sureties are subject. In the meantime, however, let us consider their opportunities for misappropriating the assets and the means of limiting this opportunity.

Sec. 58.—**Opportunity for Misappropriation.—Joint Control.** A fiduciary, under the law, has sole control of the assets of the estate, so that, in the absence of interference by the surety, his opportunity is limited only by the amount of the estate. However, it is now the very general practice of surety companies to require all applicants for bonds of this kind to give the representative of the surety company joint control of the estate. Joint control, as the term here used, contemplates that the funds are to be put in a bank and the securities in a safety deposit box, in the name of the estate subject to the joint order of the principal and the company's representative, so that they cannot be withdrawn except upon the counter-signature of the latter. And it is important, not merely to have the applicant agree to give joint control, but to obtain from him a letter addressed to the bank, or other custodian of the funds and property of the estate, consenting that such custodian may deliver the property only upon the counter-signature of the surety's representative.

In the keen competition for business, surety agents

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[1]See Sections 42 and 53.

often waive joint control in order to get a particular bond or the business of a particular man, but it is a bad practice. In the great majority of cases, most men being honest, joint control could of course be waived with perfect safety; but inasmuch as it is impossible accurately to pick out these cases in advance, and inasmuch as losses occur where they are least expected, it is suggested that joint control be made the universal rule. I have in mind a case in my own experience where a man of the very highest standing in the community and of reputed wealth—one whom anybody would have trusted—applied for an administrator's bond and suggested that joint control be waived. Considering the business gilt-edged, and desiring to retain the applicant's good will, having future business in view, I readily consented, to find about a year later that he was a defaulter for a very large sum and that of the five thousand dollars received by him as administrator, he had on hand only about twenty-five dollars, the balance having been misappropriated. The records of the companies are full of such cases, and there ought to be none. A surety company is not paid for taking any risk, but merely for the use of its name and credit, and when the bulk of the risk can be avoided so easily, it should be done. Joint control should be the universal rule.

However, in the case of receivers and trustees in bankruptcy, the referee, who is an officer of the court, is expected to and generally does exercise joint control of the money and securities of the estate, requiring them to be deposited in a bank selected and designated

by the Court. In that event, it is of course unnecessary for the surety company to exercise joint control; but in some jurisdictions the referee is lax in this respect, particularly in cases where the trustee is to conduct the business of the bankrupt, which would require the frequent issuance of checks. If in any particular case, the referee will not effectively exercise joint control, then the surety should insist upon it.

Sec. 59.—**Duties and Liabilities. In General.** A fiduciary, as we have seen, is bound faithfully to perform his duties; and this necessarily subjects him and his surety to certain liabilities, against which they must, at their peril, protect themselves. As a rule, surety companies do not leave the fiduciaries whom they have bonded to act entirely upon their own judgment, but endeavor, so far as may be reasonably possible, to see to it that they properly perform their duties, and in many cases, exercise joint control of the estate, to the end that there may be no loss under the bond. In the ensuing pages therefore, the principal duties and liabilities of fiduciaries will be indicated, and some suggestions will be made as to the proper method of performing those duties and thereby avoiding the liabilities.[1]

Sec. 60.—**Possession of the Trust Property.** The first duty of a fiduciary is to secure possession of the trust property. If it consists in part, of notes, bonds, policies of insurance and the like, he should notify the

[1] In attempting to define the more important duties and liabilities of fiduciaries, I have consulted and relied upon many authorities and text writers; and I wish particularly to acknowledge my indebtedness to Mr. Augustus P. Loring, whose "A Hand Book for Trustees" is a recognized authority.

promisors or makers of the instruments, and should obtain actual possession. And the transfer to him should be made in such a way as to identify the instruments as a part of the particular trust estate. Likewise the fiduciary should proceed at once to collect the debts due the estate. There is no fixed time within which the debts must be collected, but he must use due diligence under the circumstances.

If the trust estate consists in part of real estate, he should see that the record title is put in his name in his fiduciary capacity, or in the name of the beneficiary, as the circumstances of the case may require; and he should take possession of it, either actual or constructive. If it is under lease, he should take constructive possession of it by compelling the tenant to acknowledge him as the landlord and to agree to pay rent to him; if there is no tenant, he should take actual possession. If the beneficiary is in possession, under the terms of the trust, he need do nothing, as under these circumstances, the possession of the beneficiary is the possession of the trustee.

Sec. 61.—**Filing of Inventory.** As soon as the estate has come into the possession of the fiduciary, he should make an inventory, and file it with the clerk of the court having jurisdiction. Inasmuch as the inventory shows the assets for which the surety is liable and shows the form in which they exist, it will aid the surety in deciding what steps the fiduciary ought to take, and in guiding him in the performance of his duties. As soon as possible therefore, the surety should

obtain a copy of the inventory. A simple request to the attorney will generally bring it.

Sec. 62.—**Conversion of Estate into Proper Form.** Speaking generally, fiduciaries are appointed either to distribute the estate to those entitled to it, or to hold and invest it so that it will produce the largest income that is consistent with absolute safety of principal.

Where it is the duty of the fiduciary merely to divide the estate, as is the case with executors, administrators, receivers, assignees and the like, it is generally necessary, to convert the estate into money, so that it may be properly divided; although, in the case of estates of deceased persons, distribution can sometimes be made of the specific property. In any event, the purpose of such an appointment is to ascertain what persons are entitled to the property, and, with all reasonable despatch, to distribute it to them; and not to carry on any mercantile business belonging to the estate, or otherwise attempt to make money for the estate.

In the case of estates of deceased persons, it is the universal rule, that, in the absence of express direction, either in the will or by a proper order of court, the executor or administrator should not attempt to carry on the business of the decedent, but should immediately close it up and convert it into money. And it is to be borne in mind that the courts having jurisdiction over the estates of decedents, being courts of limited jurisdiction, and having only the powers given by statute, generally have no power to authorize an executor or administrator to conduct the business. In the

absence of express statutory authority, such an order would be void, and would not relieve the executor or administrator and his surety from liability for any loss that might result. When the estate of a decedent consists of a running business, the surety should not sign the bond of the administrator unless it is clearly understood that the business will immediately be closed and the stock sold.

In the case of receivers, assignees and the like, who are under the jurisdiction of courts of chancery, the court may, and often does, authorize them to continue the business until the further order of the court. But the business should not be continued without such express direction, and then the order of the court should be strictly followed.

Where the trust estate is to be held for investment, the form in which it exists at the beginning of the trust, is often, in part at least, not adapted to trust purposes. An individual may be engaged in business, in a partnership, or in the management of his property for the purpose of gain, and rarely has his property permanently invested without some regard to speculative value. Where a trustee receives an interest in a partnership, in a business, or in speculative or unproductive property, or in fact in any property in which he would not be authorized to invest under the terms of the instrument or prevailing law,[1] he must proceed immediately to convert all such property into proper investments.

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[1]See Section 64.

In the absence of a contrary direction, vacant land, even if it has a large prospective value, should be converted, since trust property should yield an income. All undivided estates should be converted, since the trustee has not the absolute control over them. Leaseholds and all wasting investments, such for example as stock in mining companies, where the principal is being consumed, should be converted into trust investments. Loans on personal security should likewise be converted. And the trustee should act promptly in making these conversions, for if he delays beyond a reasonable time, he and his surety will be liable for any loss of the property.

On the other hand, if the donor of the trust has provided for the continuation of the business, or the holding of the particular property, or if he has left his property prudently and permanently invested, not with a view of speculation, the trustee should not convert it, unless perhaps the investments are such as he is forbidden to make under the terms of the trust or the law.[1]

Sec. 63.—**Payment of Debts.** If the estate is liable for the payment of debts, as is always the case with estates of deceased persons, and with bankrupt and insolvent estates, it is the duty of the fiduciary, not only to pay the known debts but to give notice by publication, in the manner provided by law, of his appointment, to the end that all who have claims against the estate may have an opportunity to be heard. As a

1 See Section 64.

rule, no debts should be paid until after the expiration of the time within which claims may be filed, for if some should be paid in full, and subsequent claims should make the estate insolvent so that the creditors would not be entitled to full payment, there would be an over-payment for which the fiduciary would be liable. Generally, however, there is no objection to paying individual items which have a clear priority, such, for example, as taxes; and, in the case of estates of deceased persons, the funeral expenses of the deceased. Where there may be more than one item in a particular class, payment should not be made until after the expiration of the time for filing claims, as there may be enough items in that class to exhaust the estate and leave a deficit.

After the expiration of the time for filing claims, and if there is enough money in the estate to pay all claims, it is proper to pay such of them as have been found by the court to be proper, retaining on hand enough to pay any that may be disputed. If there is not enough to pay all, including those disputed, then none should be paid, or they should be paid only pro rata, for if the estate should be found insufficient and some have been paid in full, there will be an over-payment for which the fiduciary will be liable.

Sec. 64.—**Investment of Funds.** As we have seen, fiduciaries are divisible into two classes: those whose duty is merely to distribute the estate and those whose duty is to hold and invest it. The first class embraces executors, administrators, receivers, assignees and the like, and the second class includes guardians

and tutors of minors, committees, curators, and conservators of incompetents and certain classes of trustees. When a fiduciary of the second class has obtained possession of the estate, and has converted into money so much of it as is necessary to be converted, his next duty is to invest the proceeds. In doing so he must invest them securely so that the principal will be preserved, and he must invest them productively so that they will yield the current rate of interest.

If there are directions in the instrument creating the trust as to the manner of investing the funds, those directions must be followed; for the creator of a trust may undoubtedly specify the kind of investments that may be made with the trust funds. In the absence of such directions, the fiduciary must be governed by the law of the state in which the trust is being executed and the rules of the court having jurisdiction over the estate. If there is no law or rule of court in relation to investments, a fiduciary can safely follow the rules prescribed for the investment of funds of savings banks in the particular state. And if there is no such rule, or if it is not practicable to follow that rule, fiduciaries must be governed by sound discretion and good faith, having in view, not speculation, but a permanent investment, considering both probable income and safety of principal. They must observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of principal.

This is known as the American rule; but the courts and legislatures in the various states have, from this rule, evolved very different results. Having reference to the classes of securities in which trust funds may be invested, the courts of New York have established a rule which seems to be fairly satisfactory and reasonably safe, and which should perhaps be followed in other states, unless a more liberal rule has been clearly established by proper authority. The New York rule is that trust funds ought to be invested in government, state or municipal bonds, first mortgage bonds of corporations and first mortgages on real estate. Other states, including Massachusetts, hold that a fiduciary may also invest in stocks of business corporations such as banks, railroads and manufacturing companies, and in notes of individuals secured by the stock of such corporations, provided the corporations have acquired, by reason of the amount of their property and the prudent management of their affairs, such a reputation that cautious and intelligent persons commonly invest their own money in such stocks as permanent investments. There is no definite rule for determining who are "cautious and intelligent persons" within the meaning of this rule, nor when their investments are intended to be permanent and not speculative. At best, such securities are liable to fluctuate in value, and are therefore more or less speculative.

It is hardly necessary to add that the following kinds of investments are everywhere disapproved: loans on personal security, whether of one or more persons; investments in business ventures, whether in trad-

ing or manufacturing or otherwise; second mortgages and mortgages on leasehold property; unproductive real estate, and all investments of an untried or speculative nature. A fiduciary gains nothing by making such investments, for he must account for all profits and is responsible for all losses.

It is however not enough that a fiduciary select securities from one of the classes that are recognized as proper investments; he must also exercise a sound discretion in selecting investments within the authorized classes. He must exercise the same degree of intelligence and diligence that a man of average ability would exercise in making his own investments.

The rule is that the question of whether there was a sound exercise of discretion is to be determined according to the state of facts as they existed when the investment was made, and not in the light of later developments. But it is well known that the later developments, if they show a loss, are likely to influence the court and jury in determining the propriety of the investment. A fiduciary therefore owes it to himself and his surety to use great care and conservatism in investing the funds under his control. The danger of erring on the side of ultra-conservatism is small; for there are few, if any, cases where a fiduciary has been criticised for making investments so conservative that they do not produce an acceptable rate of interest. Before investing in bonds, he ought to consult a responsible and conservative bond house, and likewise, in making mortgage loans, he ought to consult a reliable expert on real estate values. He has a right to get

such expert advice, and if there is any incidental expense, to charge it to the estate. In practice, the commission on the sale and purchase will generally pay for the expert advice of the broker; the point is to select a competent and reliable broker.

It is also the duty of the fiduciary to exercise due care to keep the estate invested; and if he is negligent in this respect, he will be held liable for the income he might have earned.

Sec. 65.—**Care of the Trust Property.** Having obtained possession of the trust property, having converted into money so much of it as is necessary to be converted, and having paid the debts and invested the cash, it is the duty of the fiduciary to take care of the assets of the estate, and in so doing, to use reasonable skill, prudence and diligence.

We have seen that, if a public officer, deposits public money in a bank and the bank fails, he and his surety will be required to make good the loss, even though the utmost care was used in the selection of the bank. It is not so with a fiduciary. If he uses reasonable care in the selection of the bank—if, under the circumstances, a reasonably prudent man would have put his own money in the bank—he is not liable for loss resulting from the failure of the bank. As we shall see, however, in order for the fiduciary to be thus relieved, it must appear that the money was deposited in the name of the estate.[1] The securities should be kept in a safe deposit box, and the box should be rented in the

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[1]See Section 66.

name of the estate. If the securities should be kept in the home or office of the fiduciary, or even in an ordinary iron safe, and should be lost, the fiduciary and his surety would probably be held liable for the loss.

The improvements on the real estate should be insured and the taxes thereon should be paid. It should be put in condition to be rented and should be kept in repair; and if, in so doing, a substantial sum of money is necessary, an order of court should be obtained. Chattels are generally converted into money, but if, by the terms of the trust, they are to be held as a part of the estate, they should be put in as safe a place as is reasonably possible, and, if practicable, should be kept insured.

Sec. 66.—**Trust Property to be Kept Separate.** A fiduciary should not, under any circumstances, commingle the trust property with his own, but should keep it separate so that it can always be identified as trust property. The bank account should be kept in the name of the estate, or in the name of the fiduciary, followed by such language as to show that the money belongs to the estate; as for example: "John Smith, trustee under the will of Henry Jones." All the securities belonging to the estate should, if possible, be placed in the name of the estate so that they cannot be transferred to a third person except upon the signature of the fiduciary; and the safe deposit box in which they are kept should be rented in the name of the estate. Title to land, and all mortgages, should of course be taken in the name of the estate or of the beneficiary,

but never in the name of the fiduciary, in his individual capacity. Chattels should likewise be kept separate from the individual property of the fiduciary and identified as a part of the estate.

The importance of the separation and identification of the trust property ought not to be underestimated by the surety. In the first place, the fiduciary is more likely to use the trust property for his own account if it is mixed with his own or stands in his individual name; and, in the second place, even if the fiduciary has no intention of misappropriating any part of the estate, loss may nevertheless be suffered by the surety, in at least two ways.

(1) The rule is that if a fiduciary uses reasonable care in the selection of a depository for the funds, and deposits them in the manner above indicated and not in his individual name, he and his surety will be relieved of liability for loss resulting from the failure of the bank. But if he deposits the funds to his individual credit, whether commingled with his own or not, it is considered a technical conversion of the funds to his own use; and, if the bank should fail, he and his surety would be liable for the resulting loss, even though the greatest care may have been used in the selection of the depository.

(2) If the fiduciary should become insolvent and be put into bankruptcy, with the trust funds standing in his individual name, his general creditors would be entitled to the funds as against the beneficiaries of the trust; and the surety would be compelled to make good the loss. If, on the other hand, they had been carried

in the name of the estate, the creditors would not, of course, have been entitled to them. If the other property of the estate could not be identified as trust property, it likewise would go to the general creditors.

Sec. 67.—**Money to be Kept Under Exclusive Control. The Effect of Joint Control by Surety.** If a fiduciary deposits the money of the estate in such manner that it is not under his exclusive control, as where it cannot be withdrawn without the concurrence of other persons, he and his surety will be liable for loss resulting from the failure of the bank. This rule is based on the principle that it is the duty of a fiduciary to withdraw the money from the bank upon the slightest indication of danger, and that he cannot perform this duty promptly if he is hampered by the necessity of procuring the concurrent action of other persons. And this rule has been held to apply when a surety company, for the better preservation of the estate, requires and exercises joint control of the funds so that they cannot be withdrawn except upon the counter-signature of its representative. But of course, it can apply only in those States where joint control by a surety is not recognized and approved by statute, and it so happens that in many of the States such approval by statute has now been given.[1] In States where joint control by the surety

[1] Colorado.—Colo. Stat. Anno., Sec. 937.

Idaho.—Revised Codes, Sec. 2947.

Indiana.—Burns Anno. Stat., Secs. 5732 and 5762.

KENTUCKY.—May be authorized by Carrolls Statutes, 1909, Sec. 723, which provides that a surety company may stipulate for indemnity from the parties for whom it shall become responsible, and

has not been approved by statute, it should be borne in mind that when a surety company elects to accept the protection afforded by joint control, it, at the same time, becomes a guarantor of the continued solvency of the depository.

Sec. 68.—**Periodical Accounting.** It is the duty of all fiduciaries, periodically, to file reports and accounts of their administration, showing what assets have been received and what disposition has been made of them. The time when such periodical accounts should be filed is usually regulated by statute or rule of court, but the general rule is that an account should be filed at least once a year. Where a fiduciary, under order of court, is conducting a business belonging to the estate,[2] he should report much more frequently, say once a month, in order that the court may determine whether or not

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enforce any bond, contract, agreement, pledge or other security made or given for that purpose.

MARYLAND.—Code, Art. 93, Sec. 39.

MASSACHUSETTS.—With the approval of the Court appointing the fiduciary. Rev. Laws, 1902, Ch. 118, Sec. 61, p. 1150.

MICHIGAN.—Howell's Statutes. Sec. 8170. Comp. Laws, 1897, Sec. 5201

MONTANA.—Revised Code, 1907, Sec. 4181.

NEW JERSEY.—Comp. Stat., 1910, p. 2852.

PENNSYLVANIA.—P. L., 1895, p. 344. Sec. 2. Purdon's Digest (13th Ed.) p. 4522.

VERMONT.—Wih the approval of the Court. Pub. Stat., 1906, Sec. 4787.

WEST VIRGINIA.—May be authorized by Code 1913, Sec. 3184, a provision similar to that in Kentucky.

WISCONSIN.—Statutes, 1911, Secs. 1966-37.

[2]See Section 62.

the business should be further continued. This is generally regulated by the order authorizing the continuance of the business. The surety should insist that the proper reports and accounts be rendered so that he may be advised of any neglect or improper conduct on the part of the principal.

Sec. 69.—**Distribution of the Estate.** It is the duty of a fiduciary to distribute the estate as soon as the proper time comes for him to do so; and if he holds the estate an unreasonable length of time after distribution should be made, he subjects himself and his surety to certain extraordinary risks. The rule is that a fiduciary is bound to account for what was, or ought to have been, on hand when final distribution was due; and if, after that time, a part or all of the estate should be lost, even without his fault, he and his surety would ordinarily be liable for the loss. If, for example, the bank in which the money was deposited should fail, he would be liable for the loss, notwithstanding he may have used due care and had deposited the money in the name of the estate. So also, if an investment, which was proper when made, should depreciate in value or become worthless after the time when distribution was due, he would be liable.

It is not possible to state in advance when distribution in each case should be made; but it may be said, in a general way, that estates of deceased persons can ordinarily be closed within a year; and that much time is always allowed. There are, of course, many cases where more than a year is necessary; but as soon as

the debts are paid and the distributees ascertained, the distribution should be made. The estate of a minor should be transferred to him as soon as possible after he reaches his majority. A bankrupt or insolvent estate should be distributed as soon as the assets have been converted into money and the number and amount of the claims have been ascertained. Where a considerable part of the assets have been converted, a partial distribution may be made.

A fiduciary must not only distribute the estate promptly when distribution is due, but he must, at his peril, distribute it properly. If he distributes the wrong amount or pays it to the wrong person, he must bear the loss. The fact that he has been diligent or has taken advice, will not save him. The only protection is to obtain a decree of distribution, and he should see that all parties in interest are parties to the suit so that the decree will be binding upon them. If there is any doubt as to whether all parties have been joined, he may require the distributees to give bond to indemnify him and his surety against loss,[1] and the surety should for its own protection see that such bonds of indemnity are given.

Likewise the fiduciary must, at his peril, pay the distributive shares to the identical persons named in the decree, or to their proper representatives. The fact that he pays on a forged order, an invalid assignment or a power of attorney which, unknown to him, has been revoked, will not protect him. He must pay the

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[1]See Section 159.

share of a minor, or other incompetent, to his legal representatives and no other.

Sec. 70.—**Liability of Surety for Debts due by Fiduciary.** If a fiduciary is indebted to the estate committed to his care, the amount of the debt automatically becomes assets of the estate, no formal transfer from himself individually to himself in his fiduciary capacity being necessity. He will be required, as fiduciary, to account for the amount of the debt as so much cash; and this entirely irrespective of his ability, in point of fact, to pay the debt.

Inasmuch as the surety for a fiduciary is liable for all assets that come into the hands of the principal, and inasmuch as a debt due by the fiduciary to the estate is treated as an asset, it follows that the surety for such a fiduciary guarantees the continued solvency of the principal and his ability to pay the debt. This is an extraordinary risk which a surety company ought not to assume unless the fiduciary is abundantly able to pay the debt. The signing of the bond is equivalent to endorsing a note of the principal for the amount due the estate.

Sec. 71.—**Liability for Acts in Excess of Authority.** While a fiduciary must be diligent to perform the duties imposed upon him by law, he must, at the same time, be careful not to exceed his powers. He is bound to observe the limitations of the law; and, if loss result to the estate from an act in excess of his powers, he and his surety will be liable.

If, for example, he sells any of the trust property without having power to do so, or makes an unau-

thorized conversion,[1] he may be compelled to replace the property in kind or make good any subsequent increase in its value. If he makes an authorized payment, he will be compelled to replace the amount so paid. He can generally protect himself by procuring an order of court; and he should not sell any of the property, convert any of it into money, make any payment, or do any other act that may result in loss, without obtaining such an order; and the terms of the order should be strictly and exactly followed. If the court is one of limited statutory jurisdiction, he should be careful to ascertain that the court has jurisdiction to make the order. Where the directions in the instrument creating the trust are clear and explicit, it is not so important to obtain an order of court. But no harm will be done; and it is advisable to do so, particularly if there is any possibility of a different construction of the instrument.

Sec. 72.—**The Exercising of Joint Control by Surety.** We have seen that it is fast becoming the uniform practice of surety companies to require all fiduciaries to give the representative of the company joint control of the assets of the estate. Joint control is desirable because, first, it will prevent the fiduciary from appropriating the estate to his own use; and, second, it will enable the surety, in a measure, to see that the principal properly performs his duties and that he pays out the estate only for proper purposes—purposes which are authorized by law, and which the court having jurisdiction has approved, or is legally bound to

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[1] See Section 62.

approve. This, however, is not a merely perfunctory matter of countersigning checks. It requires considerable knowledge and care on the part of the surety's representative, as shown by the fact that one company, in making a partial examination into the causes of its losses during the year 1912, found, in the cases examined, a loss of nearly $20,000.00 directly attributable to the fact that its representatives permitted money of which they had joint control to be improperly withdrawn and expended. The experience of the other companies is probably just as bad, or nearly so.

In exercising joint control, the surety company's representative should see that the estate is converted into the proper form,[1] that the debts of the estate are paid, but only at the proper time and in the proper order;[2] that the funds are properly invested;[3] that any cash that may be on hand is put in a carefully selected bank, the securities in a safe deposit box, and that the other assets are properly cared for;[4] that the trust property is kept separate and identified as trust property;[5] that the assets are properly distributed;[6] and that the principal does not exceed his authority.[7]

In order for a company to be perfectly safe in the handling of its joint control cases, it would perhaps be necessary to put the matter in charge of an attorney, especially trained in the handling of estates. This it is

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1See Section 62.
2See Section 63.
3See Section 64.
4See Section 65.
5See Section 66.
6See Section 69.
7See Section 71.

not always practicable to do; but if those who are required to exercise joint control will keep in mind what has been said in the preceding pages regarding the duties and liabilities of fiduciaries, and will use their common sense and some care, there ought not to be any difficulty. There are three tests which should be applied to every payment the surety is asked to authorize.

I. Is it a proper payment in the opinion of the surety's representative? If the payment is for investment, is it a proper investment? If for the payment of a debt, is the debt a proper one to be paid at the time? If a distribution, is it being made at the proper time and to the proper person? Is the principal acting within his authority?

II. Has the payment been approved by the court having jurisdiction? Ordinarily such approval should be a condition precedent to the countersigning of any checks, and this rule applies to the following payments, which are sometimes made without an order of court:

a. The payment of the funeral expenses of the deceased. However, this expense is generally the first preferred claim against the estate, so that if there is any particular occasion for haste, it is reasonably safe to waive the order of court.

b. Any special statutory allowance in favor of the widow or children of a deceased person. If, however, the right to the payment is *absolute* or depends solely upon the judgment or discretion of the fiduciary, the order may be waived.

c. All claims against the estate whether preferred or not. None of the claims should be paid until after the expiration of the time within which claims may be allowed. Then an account showing the claims to be paid should be filed; and upon aproval of the same by the court, the debts may be paid.

d. All payments for the support and maintenance of the beneficiaries of the estate. It is necessary to be careful in such cases, for guardians of minors and conservators of the estates of incompetents often assume they have the right to support the beneficiary out of the estate when in fact they have not.

e. All investments, unless the funds are to be invested in a security which has already been approved by the court, or which the court is bound to approve.

III. Has the payment been expressly approved by the attorney for the estate? This should also be a condition precedent to the countersigning of any check. This is necessary not only where an order of court is waived, but also for the purpose of determining that any order that may have been issued is being properly interpreted. Where the attorney is a man of reasonably good standing at the bar, his approval may be permitted to carry considerable weight, although it cannot be absolutely relied upon in all cases, and it is often of advantage to call his attention to any apparent irregularity or impropriety in the payment. The or-

dinary attorney, not having come directly in contact with the hard knocks to which surety companies have been subjected, does not realize the importance of keeping strictly within the letter of the law. It is really astounding, in the light of the experience of surety companies, to note the apparent freedom with which good attorneys advise their clients who are fiduciaries to ignore or disobey the law. A good surety man is generally a safer adviser than an attorney who has not been specially trained in the handling of estates.

All three of these tests should be applied as far as may reasonably be possible. In some cases, it may not be feasible to require the express approval of the court, but in no event should any payment, about which the surety's representative has any doubt, or which has not the active and express approval of the attorney, be allowed; and the order of court should not be waived unless there is some good reason for it, and unless the ability and good faith of the attorney are undoubted.

Sec. 73.—**Substituted Surety.** In the foregoing treatment of the subject of bonds of fiduciaries, it has been assumed that the application for the bond will be made at the time of the appointment of the fiduciary and before he begins to act as such. It is considered bad policy to execute a bond for a fiduciary who has previously been acting under another bond. The extra hazards in such a case may be summarized as follows:

1. The bond may be construed to cover the entire time during which the fiduciary has been acting as such, so that the surety may be held liable for existing as well as future defaults.

2. Even if the bond should not be construed to cover the entire period, it is difficult in many cases to tell just when a default was committed; and the chances are that if the first surety should not be solvent, the substituted surety would be held liable for any default that might be found to exist, even though it may be *thought* that the default occurred before the new bond was executed.

3. The fact that a new bond is desired is evidence, either that the former surety was suspicious of the principal and obtained a statutory release, or that the beneficiaries became suspicious and asked for an additional bond for their protection. Neither of these suppositions is *necessarily* true, but the presumption is in favor of the truth of one or the other of them.

On the whole, therefore, it is considered the part of wisdom to decline all such applications, unless it is shown *positively* that the estate is intact at the time and that no suspicion of wrong doing attaches to the applicant. Joint control should, of course, be required in such cases.[1]

Sec. 74.—**Termination of Liability.** The bond of a fiduciary is a continuing obligation; that is to say, unless it is terminated in the manner provided by law, it will continue in force so long as the principal continues to act in his capacity as fiduciary. The fact that the principal may file a new bond, or fail to pay the annual premium provided for in his contract with the surety, will not release the surety from liability.

[1]See Section 58.

And furthermore, inasmuch as probate courts having jurisdiction over the majority of fiduciaries are ordinarily courts of limited jurisdiction, with the right to exercise only the powers that have been given them by statute, such courts have no right, in the absence of an express statutory provision, to relieve a surety from liability, even though a new bond with another surety be required and given. And if there is a statutory provision authorizing the court to release the surety, the statute must be strictly followed, or the order granting the release will be void.

As a matter of fact, the statutes of nearly all the states do provide that sureties on the bonds of fiduciaries may, under certain conditions, obtain a release from future liability, remaining liable always for any default that may have occurred prior to the date of the release. The statutes in the several states are by no means uniform, but the method of procedure generally prescribed is for the surety to file, with the court in which the bond was filed, a petition asking to be relieved of future liability. The court is authorized, or required, upon such petition, to order the fiduciary to account and file a new bond; and upon the filing and approval of the account and the new bond, the court is authorized to enter an order releasing the surety from liability for the future acts and defaults of the principal. If the principal fails to acount and file a new bond, in response to the order of the court, he may be attached for contempt of court and may be removed.

In some states, the application of the surety for a

release will be granted as a matter of right; that is to say, the court is *bound,* upon the filing of the petition of the surety, to make the necessary orders looking to the release of the surety. In other states, the release will be granted only when the surety alleges and proves, to the satisfaction of the court, a reason for his request; such as, that the principal is mismanaging the estate or that the surety is in danger of loss.[1]

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[1]The laws of the several States on this subject may be summarized briefly as follows:

CALIFORNIA.—Surety for executor or administrator may effect a cancellation as to future liability. Secs. 1403-5, Code Civil Proc.

Surety for guardian may be released after due notice given "when it shall appear that no injury can result therefrom to those interested in the estate." Sec. 1803, Code Civ. Proc.

COLORADO.—Surety for any fiduciary may effect a cancellation as to future liability. Sec. 936, Colorado Statutes Annotated.

CONNECTICUT. Surety upon any bond taken by a Court of Probate may, upon petition, be released upon a hearing of all parties interested "it does not appear that to grant such application would prejudice said estate." Sec. 214, General Statutes, Rev. of 1902.

GEORGIA.—Surety on bond of guardian may be released at the discretion of the Ordinary. Sec. 3052, Code of Georgia. Surety for trustee may be released at the discretion of the judge of the Superior Court. Sec. 3776, Code of Georgia.

Surety for administrator may be released in the same way. Sec. 3976, Code of Georgia.

Can surety for executor effect a cancellation of the bond? See Sec. 3891, Code.

IDAHO.—Surety for any fiduciary may effect a cancellation as to future liability. Revised Codes, Sec. 2946.

ILLINOIS.—Surety for executor or administrator may effect a cancellation as to future liability. Rev. Statutes, 1909, Ch. 3, Secs. 35-36, p. 119.

Surety for guardian, conservator or trustee may effect cancellation as to future liability. Rev. St., 1909, Ch. 103, Sec. 15, p. 1564.

INDIANA.—Surety for executor, administrator, administrator with the will annexed or *de bonis non* may effect a cancellation as to future liability. Sec. 2769, Burns Anno. St. Surety for a guardian has same privilege. Sec. 3061, Burns Annotated St.

IOWA.—Surety for any person holding a fiduciary office or trust, administrator, executor, guardian or trustee may effect a cancellation as to future liability. Sec. 1177-b of the Supp. to the Code of Iowa.

KANSAS.—Surety for executor or administrator may be released by probate court "when such court is of opinion that there is good reason therefor." Sec. 3622, General Statutes, 1909. Surety for guardian may be released in same way. Sec. 3996, G. S., 1909.

KENTUCKY.—Surety of personal representative [executor or administrator (?)], guardian, curator, assignee or trustee, committee of a lunatic master, commissioner or receiver may effect a cancellation as to future liability, and may in some cases obtain indemnity for such as may have been incurred. Sec. 4659, Carroll's Kentucky Statutes, 1909.

MARYLAND.—Surety for any fiduciary may effect a cancellation as to future liability. Art. 90, Sec. 6, Annotated Code.

When the statute gives the surety an absolute right, upon application, to be relieved of future liability, it is reasonably prudent to take that fact into consideration in passing upon applications. But where the granting of the release is in discretion of the court, to be exer-

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MASSACHUSETTS.—Surety on any bond given to a judge of probate may be released from future liability "if the court, after notice to all persons interested, finds such discharge reasonable and proper." Ch. 149, Secs., 15-17, Rev. Laws 1902, p. 1336.

MICHIGAN.—Surety upon any bond given to the probate court may effect a cancellation as to future liability. Howell's Statutes, Sec. 8171. Comp. Laws 1897, Sec. 5202.

MINNESOTA.—Surety on any probate bond may effect a cancellation as to future liability General Statutes 1913, Sec. 7423.

MISSISSIPPI.—Surety for executor or administrator may effect a cancellation as to future liability. Code of Miss., 1906, Sec. 2038. Surety for guardian may be discharged from future liability if he is in danger of loss; and mere apprehension of loss or desire to be relieved is not sufficient. Discretion of the court controls. Code of 1906, Sec. 2407 and notes.

MISSOURI.—Any person bound as surety on any bond given by any officer, including executors, administrators, guardians, curators, assignees, receivers, trustees, *may* be released from future liability on application to the court authorized to take and approve such bond, but the matter is in the discretion of the court. Rev. Statutes 1909, Secs. 11281-88.

MONTANA.—Surety for executor or administrator may effect a cancellation as to future liability. Rev. Code of 1907, Secs. 7467-69. Probate court may discharge surety on guardian's bond "when it shall appear that no injury can result therefrom to those interested in the estate." No express provision by which surety may start the proceeding. Rev. Code, 1907, Sec. 7810.

NEVADA.—Surety on the official bond of any executor or administrator or on the bond of any person where by law a bond or undertaking is required may effect a cancellation as to future liability. Rev. Laws, 1912, Secs. 2880-82.

NEW HAMPSHIRE.—Surety for any fiduciary may, in the discretion of the judge of the probate court, be released from future liability. Pub. St., Ch. 199, Sec. 3, p. 648.

NEW JERSEY.—Surety for any trustee, committee, guardian, assignee, receiver, executor, or administrator, may effect a cancellation as to future liability. Compiled Statutes, 1709-1910, p. 5051; P. L., 1894, p. 222.

NEW YORK.—Surety for any fiduciary may effect a cancellation as to future liability. Sec. 812, Code Civ. Proc.

NORTH CAROLINA.—Surety for guardian may be released if he "is in danger of sustaining loss by his suretyship," and if, upon a hearing, "the Clerk of the Superior Court deems the surety entitled to relief." Pell's Revisal of 1908, Sec. 1783. Surety for executor, administrator or collector has same remedy. Pell's Revisal, Sec. 33.

OHIO.—Surety for executor or administrator may be released if court is of opinion there is good reason therefor. Sec. 6204, Bates Annotated Statutes.

Surety for guardian may effect a cancellation as to future liability. Sec. 6273, Bates Annotated Statutes.

Surety for assignee or trustee may be released "if the court is satisfied of the reasonableness of the application." Sec. 6339, Bates Anno. St.

cised only upon cause shown, the provision is not of much practical value. The court will ordinarily not grant the petition unless there is an allegation and proof of mismanagement; and it is generally not wise for a surety to allege and prove that the principal has dissipated any part of the estate, and thereby precipitate a liability. Furthermore, the procedure under such a statute is generally cumbersome and more or less expensive, involving the taking of testimony. While such

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OREGON.—Surety for any fiduciary may effect a cancellation as to future liability. Lord's Oregon Laws, Sec. 685.

PENNSYLVANIA.—Surety for any fiduciary may obtain release from future liability "if the court, after due notice to all the parties interested, deem it reasonable and proper." P. L., 1907, Ch. 384. Purden's Digest, 13th Ed., Supp. 1905 to 1909, p. 6057.

RHODE ISLAND.—Surety for any fiduciary may be released on his petition if it appears, upon a hearing of all parties interested, that the petition can be granted without prejudice to the estate. General Laws, 1909, title XXXIII, Sec. 12, p. 1165.

SOUTH CAROLINA.—Surety on administration bond, who conceives himself in danger of being injured by the suretyship, may petition the probate court for relief, and the court may make such order for the relief of the petitioner "as may not impair or effect the rights of the parties interested in the estate." Code of 1902, Sec. 2520.

Surety for guardian may be relieved upon the same terms and conditions. Code 1902, Sec. 2671.

TEXAS.—Surety for executor or administrator may be released from further liability if the County Judge is "satisfied that a new bond should be required." Sayle's Civil Statutes, Arts. 1952-56.

Surety for guardian may be released from future liability upon same conditions. Art. 2608.

UTAH.—Surety for any fiduciary may effect a cancellation as to future liability. Compiled Laws 1907, Sec. 430-5.

VERMONT.—Surety for executor, administrator, trustee or guardian may be released "if upon notice and hearing it appears to the court that such surety is in danger of being injured." Public Statutes 1906, Sec. 3022. See also Sec. 3175.

VIRGINIA.—See Sec. 179, Pollard's Code.

WEST VIRGINIA.—Surety on any bond which is required to be approved by any court, board or officer may terminate his liability. Code 1913, Secs. 271-2. See also Secs. 4035-36.

WASHINGTON—Surety for any executor or administrator, or on the bond or undertaking of any person where by law a bond or undertaking is required, may effect a cancellation as to future liability. Ballinger's Code, Secs. 1529-32.

Surety for any guardian may be released upon the same conditions.

WISCONSIN.—Surety for any fiduciary may effect a cancellation as to future liability. Sec. 4281-b, Wisconsin Statutes 1911.

WYOMING.—Surety for executor or administrator may, *in the discretion of the court,* be released from future liability. Compiled Statutes, Secs. 5544-46.

Court may require new bond to be given by a guardian and may discharge the existing sureties from further liability; but there is no provision by which surety may start the proceeding. Comp. Statutes, Sec. 5783.

a statute may be of advantage in some cases, it is generally not prudent, in passing on an application, to put any dependence in it.

There are many cases which may be accepted where there is a satisfactory provision for release, but which would have to be declined where there is no such provision. Where the bond is to continue in force only for a short time, the matter is not so important. But where the bond will be in force for a long period, as in the case of guardians of young children and the like, it will often happen that a risk, which appeared to be good when the bond was signed, will turn out to be undesirable before the termination of the trust. In considering applications for such bonds, in states where there is no satisfactory provision for release, great care ought to be exercised; and they should be issued only for applicants of the highest class, or where strict joint control is obtained.

The limitations upon the power of a probate court to release a surety for a fiduciary, and the effect of the giving of a new bond by the fiduciary are matters which are very often misunderstood. It may be well, therefore, to make it perfectly clear, even at the expense of some repetition, (1) that a surety for a fiduciary can be relieved of liability only when the method (if any) pointed out in the statute has been strictly followed; (2) that the mere giving of a new bond by a fiduciary has absolutely no effect upon the liability of the surety on the original bond, except perhaps to make the sureties on both bonds jointly liable; and (3) that, where

the statutory provisions for release have not been *strictly* complied with, an order of the probate court, directing that the surety on the original bond be released is absolutely void.

The fact that so many people fail to understand and appreciate these three propositions leads to many complicated and embarrassing situations. It often happens that a fiduciary tires of paying the annual premium to the surety company, or objects to the surety company's requests for information, and thereupon files a new bond with personal sureties and refuses to pay further premiums, contending that the original surety is released by the filing of the new bond. He consequently feels that the surety company is trying to "gouge" him when it demands that the premium be paid or that a valid statutory release be obtained. If there is no statutory provisions for release, the surety must of course carry the liability and ought therefore to be compensated. Where there is a provision for release, and the surety attempts to obtain a release by petition, the principal often refuses to file another bond, contending that the bond already filed is sufficient. That bond however is not sufficient, for the statute provides that a bond must be filed *in response* to the petition, and a bond filed prior to the petition does not meet the requirements of the statute; and it often happens that the court having jurisdiction will agree with the principal and refuse to compel him to file a new bond. That leaves the surety with no alternative but to carry the liability without compensation or to sue for the premium. Some-

times a case is further complicated by the fact that, notwithstanding the statutory procedure has not been followed, (as where the court accepts as satisfactory a bond filed prior to the petition), the court orders that the original surety be released. It is then particularly difficult to get a valid release; for generally neither the principal nor the court will make another move in that direction.

It may be hard for a layman to understand that an order of court, directing that a surety be released, is not valid; but, where the statute has not been strictly complied with, the invalidity of such an order has been declared by the courts in too many cases to be now open to dispute.

CHAPTER IV.

COURT BONDS—CREDIT GUARANTEES.

Sec. 75.—**Scope.** In the last chapter we considered one class of court bonds, namely, those of fiduciaries, but there is another class of court bonds for which surety companies have many applications. The bonds to which we are now referring are given by litigants, and are generally required by law for the purpose of protecting the adverse party from loss in the event the principal fails to make good his contention in the pending suit. This class includes appeal, attachment, injunction and replevin bonds; bonds to dissolve an attachment or an injunction or to secure the return of property seized by writ of replevin; bonds to indemnify a sheriff or a marshal against loss in releasing or seizing property; bonds of petitioning creditors in a matter of bankruptcy or receivership; bonds to release ships from seizure in admiralty proceedings, and some others which it is not important now to enumerate.

Sec. 76.—**The Underwriting of Judical Credit Guarantees.** The several classes of bonds that have heretofore been discussed guarantee, mainly, that the principal will not misappropriate the money or property that may come into his hands. The bonds which are the subject of this chapter are different. They guarantee, in effect, that the principal, if unsuccessful in the litigation in which the bond is filed, will satisfy the judgment of the court. To do so usually requires

the payment of money. Accordingly the surety on one of these bonds guarantees the credit of the principal, in the same way that the endorser on a promissory note guarantees the credit of the maker; that is, he guarantees the ability of the principal to pay the requisite amount on due and legal demand—legal demand being the judgment or order of the court. The nature or quality of the risk depends, therefore, almost entirely upon the financial standing of the principal: if he has the means to satisfy the judgment, the surety will sustain no loss; if he has not, the surety will sustain a loss,—and this entirely irrespective of the moral standing of the principal and his good intentions.

While these bonds do guarantee the payment of money, the guarantee is generally not absolute, that is, to pay in any event, but only to pay in case the principal is unsuccessful in the pending litigation. But it must be distinctly borne in mind at all times that it is not within the province of a bonding company to speculate on the success or failure of an applicant in a particular case. There are always two opposing litigants, each of whom we may assume thinks he is right; the object of the suit being to determine this question. Therefore, a bonding company should not, under any circumstances, no matter how clear the applicant's case may seem, assume that the applicant will win the case and sign the bond on that assumption. The liability ought to be estimated on the assumption that the applicant will lose the case. As already stated, the premium on bonds is merely for the use of the surety's name and credit. This is particularly true with respect to bonds

of this character; and the applicant ought to be required to protect the surety against possible loss, either by the deposit of collateral security, or otherwise, to the satisfaction of the surety. The applicant ought to protect the surety in the same manner and to the same extent as he would be required to protect a bank from which he borrowed an amount equal to the estimated liability on the bond. And there is this difference between the case where a bank loans money and where a surety signs a bond of this kind: a loan is made for a period of at most four months, and in many cases less, while it may be a year or more before the pending litigation in which the bond is filed, will end. In the meantime, a principal, who was in good condition financially when the bond was signed and who may have remained so for a period of four months or more, may have become insolvent and unable to satisfy the judgment. It is therefore necessary for bonding companies to be even more careful than banks, for the term of credit is longer.

As a rule collateral security, in the shape of cash or its equivalent in marketable securities, should be required on all bonds of this kind, and it is not within my province to say when, if ever, a man is sufficiently strong financially to warrant the execution of a bond of this kind without collateral, as different companies have different requirements, and circumstances alter cases. However, it may be within the bounds of propriety to say that collateral should not be waived unless the applicant is a partnership or corporation which does not depend for its success upon any one man, and

which has a well established business which is not speculative in its nature; unless the concern is rated by the mercantile agencies at fifteen times the amount of the bond and has the highest grade of credit; unless the financial statement is verified to a reasonable extent,[1] and confirms the report of the mercantile agencies, and unless the applicant bears a first-class reputation, and appears to be honestly fighting the case and not merely attempting to postpone payment pending receipt of funds to meet the obligation.

It is suggested that each underwriter, before waiving collateral requirements, obtain the express consent of his company, or follow explicitly the rules laid down by it. The thing to be made clear here is, not so much when these bonds may be written without collateral, as that they are credit guarantees, and that the surety ought to be fully protected against possible loss. While it would be a good safe rule to require collateral security to the *full amount* of the bond in all cases of this character, it is well to bear in mind that people generally get bonds of this kind where the requirements are the least burdensome, and therefore sound business policy requires all the liberality that is consistent with safety. It follows that the underwriter who, in arranging for security, most nearly approximates the *actual* liability on the bond, and at the same time completely protects his company, will be the most successful.

The general nature and underlying principles of these bonds, and of the judicial proceedings in which

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[1]See Section 107.

they may be required, will be considered, to the end that, by applying those principles to any particular case, the extent of the liability can be ascertained with sufficient accuracy to permit the surety to make proper arrangements for its protection without, at the same time, placing any unnecessary burden upon the applicant.

Sec. 77.—**Appeal or Supersedeas Bonds.** The bond that is perhaps most frequently needed in the course of judicial proceedings is the bond on appeal. Whenever there is a judgment or decree against a litigant, and he desires to take the case to a higher court, and, in the meantime, to prevent the execution of the judgment, it is necessary to give an appeal bond, that is, a bond to supersede or take the place of the judgment,—the condition of which is, in effect, that the principal will prosecute the appeal without unnecessary delay, and satisfy the judgment or decree, with interest and costs, in case it be affirmed by the appellate court.

When a surety signs such a bond, he undertakes that, if the judgment be affirmed, the principal will do whatever the court has ordered him to do or pay the damages resulting from his failure to do so. The theory upon which such a bond is required is that since the successful litigant is, by the appeal, deprived of his right to have the order executed at a time when, in theory at least, it could have been executed, he ought, in case the order be affirmed, to be put in the same position as if there had been no appeal; or, in other words,

he ought not to be prejudiced by the possible insolvency of the principal pending the appeal.

In the great majority of cases, appeals are taken from judgments or decrees for the payment of money; and, in such cases, the actual liability, in the event of affirmance, is for the amount of the judgment, with interest and costs, although the penalty of the bond is generally required by law to be double the amount of the judgment. Where the appeal is not from a money judgment, the liability will be for the actual damages resulting from the failure of the principal to comply with the judgment or order. If, for example, the judgment requires the delivery of property, the measure of damages, in case of the affirmance of the judgment, and the failure of the principal to comply with it, will be the value of the property, plus the value of its use pending the appeal, and costs. In determining the probable damages, each case will have to be tested by its own peculiar circumstances; but it is to be borne in mind that, if the amount of damages or liability that will accrue upon an affirmance of the order cannot be definitely fixed in advance at an amount less than the penalty of the bond, then the amount of the bond is the only safe estimate.

In some cases, a litigant may, without taking an appeal, obtain a temporary stay of execution of a judgment against him by giving what is called a supersedeas bond or a bond to take the place of the judgment. The liability on such a bond is the same as if an appeal had been taken; that is, the surety undertakes

that the principal will satisfy the judgment at the end of the stipulated period.

Where the judgment or decree does not order that anything be done by either party to the suit, but simply denies the relief asked by the plaintiff or complainant, it is generally necessary to give a bond only for the payment of the court costs on the appeal. At any rate, that is generally the maximum liability.[1]

Sec. 78.—**Bonds for Costs.** It is often necessary, in order to institute a suit, to give a bond conditioned to pay the court costs, such as the fees of the clerk of the court, the sheriff and the like. Such bonds do not generally exceed $250.00, or at the most $500.00; and it is hardly worth while to try to estimate the probable amount of the costs where the penalty of the bond is so small. If collateral security is to be required, it is generally reasonable to ask for an amount equal to the penalty of the bond.[1]

Sec. 79.—**Attachment Bond.** Attachment or provisional seizure is a taking of the defendant's property into custody by the sheriff on a summary process from a court, in advance of the trial of the merits of the case, as security for the payment of any judgment that may be recovered. It is not an independent proceeding but one merely in aid of a suit commenced concurrently with or before the proceeding in attachment. The remedy is not available in all cases, but only in certain special cases mentioned in the statute; as for

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[1]As to the matter of protecting the surety on these bonds, see Section 76.

example, where the defendant is a non-resident of the State, an absconding debtor, or a foreign corporation, or where he is about to dispose of, conceal or remove his property out of the state with intent to defraud his creditors.

The writ of attachment will never be issued unless the plaintiff gives a bond conditioned that, if it be finally decided that the writ ought not to have been issued, he will pay any damages the defendant may sustain as a result of the issuance of the attachment. In order to sustain the attachment, it is necessary for the plaintiff not only to recover a judgment against the defendant but also to show that at least one of the statutory grounds for attachment exists.

The property is not delivered to the plaintiff, but is held by the sheriff, so there is no liability for the return of the property, but only for the damages that may be sustained by the defendant as a result of being deprived of the possession and use of the property. The statutes usually provide that the penalty of the bond shall be double the value of the property to be attached, but this is not necessarily a fair estimate of the liability. The two elements that usually go to make up the damages in a case of wrongful attachment are (1) the value of the use of the property for the time defendant was deprived of it,—although real estate can be attached without being taken out of the possession of the defendant,—and (2) the depreciation, if any, in the value of the property as a result of the attachment.

The value of the use of the property is not difficult

to ascertain with reasonable accuracy. If money, legal interest is, of course, the value of its use; if other property, ordinarily the fair rental value would be the value of its use. The probable depreciation in value is more difficult to ascertain in advance. It will depend upon the nature of the property. Money will, of course, not depreciate at all; real estate will ordinarily not actually depreciate, although the defendant may, as a result of the attachment, be prevented from making an advantageous sale, and may thereby be damaged. But if, for example, the assets of a running business are wrongfully attached, so that the business is stopped, the resulting loss may be great; and in such cases, the damages may equal or even exceed the value of the property at the time of its attachment.[1]

Sec. 80.—**Bond to Dissolve an Attachment.** The statutes of the various states, as a rule, provide that when an attachment has been issued and defendant's property seized, he may have the property returned to him by giving bond with surety conditioned, either that he return the property, if ordered, or pay any judgment that may be rendered against him, with interest and costs. There is a technical distinction between these two kinds of bonds, but, for the purpose of estimating the possible liability, both may be considered together. The practical effect, in either case, is that the bond stands in the place of the property; and while the plaintiff is deprived of the security that was afforded by the property, he has the bond in its place.

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[1]As to the matter of protecting the surety on these bonds, see Section 76.

The liability cannot, in any event, exceed the amount recovered by the plaintiff, with interest and costs; and if the bond is conditioned only for the return of the property, it cannot exceed the value of the property, which, of course, may be less than the amount of the judgment. The statutes may provide for a bond in double the value of the property, or in double the amount claimed by the plaintiff, but is an unnecessary hardship on the applicant to require collateral for more than the actual liability. If however this cannot be definitely fixed at a sum less than the penalty of the bond, then of course, the amount of the bond is the only proper estimate of the liability.[1]

Sec. 81.—**Injunction Bond.** An injunction is a judicial process issuing out of a court of chancery, whereby a party is required to do or to refrain from doing a particular thing. The ordinary form is one which operates to prevent the performance of an act, although the other, which operates to require an act to be done, may be issued. The latter is called a mandatory injunction, and the former, a prohibitory injunction.

As a condition precedent to the issuance of an injunction, it is the uniform practice to require plaintiff to give a bond conditioned that, if it be finally decided that the injunction ought not to have been granted, he will pay all damages that may be sustained by the defendant as a result of the issuance of the injunction. No useful purpose would be served in at-

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[1]As to the matter of protecting the surety against this liability, see Section 76.

tempting to formulate rules for determining, in advance, the probable damages in a particular case. The amount of the bond is a matter within the discretion of the court, to be fixed in each case according to circumstances; and it is reasonable to assume that the court's estimate is as nearly correct as is reasonably possible, and therefore, that the penalty of the bond represents the probable damages.[1] While it is generally found, at the conclusion of the case, that the penalty of the bond is larger than the amount of the damages actually sustained, there is usually no other basis upon which the probable damages can, with reasonable prudence, be estimated.

When the injunction restrains the defendant from collecting a note, judgment or mortgage, it is generally held that the surety is absolutely liable under the bond for the *full amount due* on the debt, the collection of which was enjoined; and this entirely irrespective of the *actual* loss suffered in consequence of the delay caused by the injunction. The fact that the security for the debt was inedaquate at the time the injunction was issued or that it was not lessened by the injunction or that the debtor was wholly or partially insolvent at the time the injunction was issued makes no difference. In such cases it is particularly necessary that the surety obtain good collateral security to the full amount of the bond, or the full amount of the debt and probable interest.[1]

Sec. 82.—**Bond to Dissolve an Injunction.** After

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[1]As to the matter of protecting the surety, see Section 76.

an injunction has been issued, the court may, in its discretion, dissolve the injunction on the giving of a proper indemnity bond by the defendant. Such a bond would be conditioned, in effect, to pay the damage the plaintiff may sustain as a result of the performance of the act or acts originally enjoined. The amount of this bond, like that of an injunction bond, is a matter within the discretion of the court, and is fixed in view of the special circumstances of each particular case.[2]

Sec. 83.—**Replevin Bonds.** Replevin is an action to recover the possession of specific articles of personal property, whereby the articles, are, at the commencement of the suit, seized by the sheriff and delivered to the plaintiff. In such cases, it is necessary for the plaintiff to give a bond conditioned for the return of the property, if a return is ordered, and for the payment of all costs and damages adjudged to the defendant. The law usually requires that the amount of the bond be double the estimated value of the property; and while it is desirable, from considerations of safety, to require security for the full penalty of the bond, yet, in most cases, the actual liability will not be so great. The maximum liability is for the value of the property, with costs and counsel fees, and the damages suffered by the defendant as a result of being deprived of the use of the property, which is usually figured at the fair rental value. If these items can be arrived at, with reasonable definiteness, they will be a fairly safe estimate of the liability.

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[2]See Sections 76 and 81.

Where the property is susceptible of joint control by the surety's representative, it is sometimes feasible to arrange for it, so that, if so ordered, the actual property may be returned, thus reducing, to that extent, the possible liability.[1]

Sec. 84.—**Redelivery Bond In Replevin.** In many of the states, the statutes permit a defendant in replevin, upon the execution of a re-delivery bond, to retain possession of the property replevied, pending the termination of the replevin action. This bond is sometimes called a *retorno habendo* bond. The bond is conditioned for the delivery of the property to the plaintiff, if ordered, "in like good order and condition as when taken." The bond will be satisfied by a return of the property in the same or a better, but not in a worse, condition, there being no liability for any costs or damages.[1] If therefore the property can be subjected to joint control by the surety's representative, so that it can certainly be returned, there can be no loss under the bond, except for any injury to the property whereby it is put in a worse condition.

In some states, in order for the defendant in replevin to regain possession of the property, it is necessary for him to re-take it on a new writ of replevin and to give a regular replevin bond. The liability on such a bond is the same as on that of the plaintiff in a replevin action.[2]

Sec. 85.—**Bond in Case of a Distraint for Rent.** The law of nearly all of the states permits the landlord

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[1]As to the matter of protecting the surety, see Section 76.
[2]See Section 83.

of leased real estate to cause the personal property of the tenant, found on the premises, to be seized by the sheriff or constable as security for the payment of rent alleged to be due. Before the property can be seized, or distrained, as it is technically called, it is generally necessary that the landlord give a bond conditioned to pay all damages that may be sustained in case it be finally decided that the distraint was unlawfully made. If, under the law of the particular state, the property is to be sold, or delivered to the landlord, in advance of the final determination of the case, the measure of liability under the bond will be the value of the property distrained, together with damages for its detention, as in the case of a replevin.[1] Where however the property is to be held by the sheriff or constable, pending the final determination, the liability will be only for the damages sustained by the tenant as a consequence of being deprived of the possession and use of the property,—as in the case of an attachment.[1]

Sec. 86.—**Bond to Release a Distraint.** Where the property of a tenant is seized for the payment of rent alleged to be due, and the tenant desires to dispute the landlord's right to collect the rent, he may ordinarily cause the property to be returned to him, upon giving bond conditioned to return the property if ordered to do so by the court, or to pay whatever judgment the landlord may recover in the suit. The liability under such a bond is practically the same as under a bond to dissolve an attachment.[2]

1See Section 79. As to the matter of protecting the surety, see Section 76.

2See Section 80

Sec. 87.—**Indemnity Bonds to Sheriff or Marshal. In releasing property.** In the course of the administration of justice, it often becomes the duty of a sheriff or marshal to take personal property into his possession and hold it pending the termination of a suit. Where this has been done, the court will sometimes order the sheriff to deliver the property to one of the parties to the suit upon his giving to the sheriff a bond conditioned for the return of the property, if ordered. Whatever may be the penalty of the bond, the liability is for the value of the property not so returned,—that and nothing more. The same thing would apply in case the sheriff voluntarily delivered the property upon the giving of a similar bond for his protection. In some cases all or a part of the property can be subjected to joint control, thus reducing the chance of loss or wiping it out altogether.[1]

Sec. 88.—**Indemnity Bonds to Sheriff or Marshal. In seizing property or making arrest.** If a sheriff or marshal, in attempting to execute the process of a court, by mistake, seizes property which in fact does not belong to the defendant, or, in any other way, violates his duty, to the injury of an innocent third person, he may incur a liability for the damages thereby sustained. It is therefore the sheriff's privilege, as a condition precedent to seizing a particular piece of property, or doing any other act, at the request of a party to a suit, to demand of him a bond with surety, to indemnify him against liability or loss. In each instance, the sheriff

[1]As to the matter of protecting the surety in case full joint control cannot be secured, see Section 76.

will fix the penalty of the bond, having in view the circumstance of the case; and it may be assumed that the sheriff is the best judge of the liability he may incur. The amount of the bond is therefore the proper estimate of the possible liability.[2]

Sec. 89.—**Libellant's Bond in Admiralty.** Where a suit is brought against a ship in the District Court of the United States, sitting as a court of Admiralty, and the plaintiff desires to have the ship libelled, that is, taken into the custody of the United States Marshal and held as security for any judgment that may be rendered in the pending suit, he may be required to give a bond to indemnify the marshal against loss as a result of making the seizure. This bond is similar to that given to a sheriff, under similar conditions,[1] and the liability ought to be estimated at not less than the full penalty of the bond.[1]

Sec. 90.—**Bond to Release a Libel or a Stipulation for Value.** Where, in a proceeding in a court of admiralty, a ship has been libelled, the owner of the ship may cause it to be released by giving a bond conditioned to pay any judgment that may be recovered by the libellant (plaintiff) with interest and costs. Such a bond is commonly called a "stipulation for value." The penalty of the bond is generally fixed by agreement of counsel, or, if they cannot agree, it is fixed by the court. In either event, it is fixed with a view of the facts of the individual case, so that the amount of the bond should be the minimum estimate of liability. It may be

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1See preceding Section.

2As to the matter of protecting the surety, see Section 76.

assumed that the attorneys and the judge (who will determine the amount to be recovered, there being no jury in a court of admiralty) know as much about the probable recovery as anybody else, and a surety company certainly ought not to presume to have greater knowledge.[2]

Sec. 91.—**Bond of Applicant for the Appointment of a Receiver.** When a petition is filed in a court of chancery for the appointment of a receiver, the court may, as a condition precedent to the granting of the petition, exact from the petitioner a bond conditioned, in effect, he will pay all damages that may result from the appointment and the acts of the receiver, that if it be finally decided that the receiver should not have been appointed. When, therefore, the appointment is finally confirmed, liability ends. The amount of the bond is to be fixed by the court in view of all the circumstances; and, inasmuch as an appointment generally disrupts an existing concern, destroying or impairing its credit and business, it is not usually prudent to estimate the liability at less than the penalty of the bond.[1]

Sec. 92.—**Bond of Petitioning Creditors in Bankruptcy.** Where a petition for an involuntary bankruptcy is filed, the court may, upon specific proof that the alleged bankrupt has committed an act of bankruptcy, and in order to preserve the property from deterioration, issue a warrant to the marshal to seize and hold the property, or may, upon application of creditors, appoint a receiver to take charge of the property until

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[2]As to the matter of protecting the surety, see Section 76

the petition is dismissed or the trustee has qualified. Before such a warrant of seizure will be issued, the petitioners will be required to give a bond conditioned for the payment to the bankrupt, of all costs, expenses and damages occasioned by the seizure and detention of the property, in case the petition be dismissed.

It is possible in such cases to require the alleged bankrupt to produce his books of account in court and submit himself to an examination before the judge; and if the petitioning creditors are prudent, they will avail themselves of this right, and ask the appointment of a receiver only in the event it is shown, to the satisfaction of the court, that the defendant is a bankrupt. If this is done, there is small probability that the petition will be thereafter dismissed. On the other hand, if the petitioners blindly ask the appointment of a receiver, the petition may be subsequently dismissed, and there may be a liability for the full amount of the bond.[1] However the amount of these bonds is generally nominal, and they are executed by the companies with considerable freedom.

Sec. 93.—**Removal Bonds.** The law provides that under certain conditions, a case may be removed by the defendant from a state court, in which it was brought, to the United States Court for the proper district. And under some conditions a case may be removed from one state court to another on account of alleged prejudice or local influence in the place where it was originally brought, or for other statutory reasons. In the case of

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[1] See Section 76.

removal from a state to a Federal Court, it is necessary for the defendant to give a bond conditioned that he will enter, in the court in which the case is to be removed, on the first day of its next session, a copy of the record in the suit and pay all costs that may be awarded by the court, if said court shall hold that the suit was improperly removed. These bonds are in the penalty of five hundred dollars; and, inasmuch as the costs may be that much, the possible liability should not be estimated at less than the penalty of the bond.

In event it should appear to the satisfaction of the court to which the case is removed that the suit does not really and substantially involve a dispute properly within the jurisdiction of the court, or that the parties to the suit have been improperly or collusively joined for the purpose of creating a case removable under the law, the Court will remand it to the court from which it was removed. The court may remand the case whenever the want of jurisdiction appears, whether before or after hearing or trial or even after judgment. The bond therefore continues in force until the final termination of the litigation and the settlement of the judgment.

In the case of removal from one state court to another, a bond is generally required. In some states it is conditioned merely to pay the costs in event the removal be found to be improper; in other states it is conditioned to pay any judgment that may be rendered. The language of the bond and of the statute should be examined. If it is merely to pay the costs, four or five

hundred dollars would ordinarily represent the maximum liability. When, however the bond is conditioned to pay the judgment, the nature of the case must be taken into consideration and the amount of probable liability determined accordingly. Generally, however, the amount of the bond is the only safe estimate of liability, as the court will probably fix the amount of the bond with reference to the facts of the particular case.[1]

Sec. 94.—**Bond on Order of Arrest.** In some states, a person may, under certain circumstances and conditions, be arrested and held to answer a demand against him in a civil action. This is an extraordinary remedy, and it is a rule of almost universal application that the plaintiff is not entitled to have the defendant in a civil action arrested until he has given bond, with surety, conditioned for the payment of the costs and damages that defendant may sustain by reason of the arrest, in case it be finally decided that defendant ought not have been arrested.

Inasmuch as this bond covers not only actual costs and expenses resulting from an improper arrest, but also damages for mental anguish and physical illness; and inasmuch as these damages cannot be estimated in advance, with any degree of definiteness, it would not be prudent to consider the possible liability as less than the penalty of the bond.[1]

Sec. 95.—**Bail Bonds.** One who has been charged with the commission of a crime and arrested, may, ex-

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[1]As to the matter of protecting the surety, see Section 76.

cept in certain specified cases, have himself released by giving bond, with surety, conditioned to appear, at the proper time, in the court in which the charge is pending and submit himself to a trial. It being impossible to estimate in money, the loss to the state from his failure to appear, the rule, in event he does so fail, is that the entire penalty of the bond is thereby forfeited.[1]

There is another feature about these bonds that should receive particular attention. The theory upon which an accused person is allowed to be released upon giving bail, is not that the crime may be atoned for by the payment of money or that the state would as soon have the money as prosecute the accused. It is rather that, by giving bail, a third person, the surety, becomes specially charged with the duty of seeing to it that the accused does appear for trial, and that the surety will perform that duty rather than pay the penalty of the bond. Carrying out this theory, it is the general rule, to which however there are some exceptions, that the accused is not allowed to put up cash himself or to do so indirectly by reimbursing the surety. The courts, therefore, will not generally lend their aid in enforcing any attempt on the part of the surety to recover from the principal the amount he has been required to pay, or in realizing on any collateral security he may hold. In practice, of course, a surety company is seldom, if ever, willing to undertake this personal responsibility at the risk of being compelled

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[1]See Section 76.

to pay the penalty of the bond without hope of reimbursement. It is important therefore, when such bonds are signed, to obtain collateral security of such a nature as to be immediately convertible into money without any legal proceeding or publicity. Real money, which does not need to be converted, is perhaps the only satisfactory thing, although there would seem to be no necessary objection to such high-grade state, municipal and railroad bonds as are quoted on the New York Stock Exchange and could therefore be converted without the necessity of any signature, any delay or any publicity.[1]

In certain of the States the law authorizes a person accused of crime to deposit with the Clerk of the Court cash in lieu of bail; and it has been held that it is not contrary to the public policy of such a State for an accused person to indemnify the surety on his bail bond; and, therefore, any deed, mortgage, bond of indemnity or other instrument given for the protection of the surety, whether given by the accused or some other person, will be enforced. A cash deposit in lieu of bond with surety is authorized in the following States:

ARKANSAS.—Kirby's Digest, 1904, Sec. 2179.

CALIFORNIA.—Penal Code, 1906, Sec. 1295

DISTRICT OF COLUMBIA.—Code, 1911, Sec. 938.

IDAHO.—Revised Codes, Sec. 8120

INDIANA.—Burns' Anno. Stat., Sec., 2017.

IOWA.—Code, 1897, Sec. 5524.

KANSAS.—General Stat., 1909, Sec. 6721.

MASSACHUSETTS.—Rev. Laws, 1902, Ch. 217, Sec. 77, p. 1832.

MINNESOTA.—General Stat., 1913, Sec. 9084.

MONTANA.—Rev. Code, 1907, Sec. 9461.

NEVADA.—Rev. Laws, 1912, Sec. 7330.

NEW HAMPSHIRE.—Acts, 1903, Ch. 28.

NEW YORK.—Code Crim. Proc., Secs., 586-9.

NORTH CAROLINA.—May give mortgage on real estate, which would seem to indicate the same policy. Pell's Revisal of 1908, Sec. 266.

NORTH DAKOTA.—Rev. Codes, 1899, Sec. 8451.

OREGON.—Lord's Oregon Laws, Sec. 1660.

SOUTH CAROLINA.—Criminal Code, 1912, Sec. 37.

SOUTH DAKOTA.—Code Crim. Proc., Sec. 590, p. 734.

TENNESSEE.—Code, 1896, Sec. 7131.

WASHINGTON.—Rem. and Bal. Code, Sec. 2089.

WISCONSIN.—Statutes, 1911, Sec. 4816.

WYOMING.—Comp. Stat., 1910, Sec. 6087.

Sec. 96.—**Bond on Sale of Real Estate of a Deceased Person Before Expiration of Time for Filing Claims.** Those who have claims against the estate of a deceased person are by law given a specified time, generally about six months or a year, within which to present their claims to the probate court for allowance. Inasmuch as the entire estate of a deceased person is liable for the payment of his debts, it is apparent that one is not safe in purchasing property left by deceased persons until after the expiration of the time within which claims may be filed.

It often happens however that before the expiration of that period, the heirs desire to sell some of the real estate and find a man who would take it if the title were clear, but who is unwilling to do so except upon the giving of a bond to indemnify him against loss, costs, counsel fees and expenses, in event any creditors of the estate should assert their claims against the property in question. The maximum possible liability under such a bond would be the value of the property plus interest, costs, expenses and counsel fees.[1]

Inasmuch as the personal estate must be exhausted before the creditors can take the real estate, there may be cases where, on account of the large amount of personal property left by the decedent, as compared with the amount of his known debts, a surety company would be justified in executing such a bond without collateral. But it is common knowledge that in many cases where

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[1]As to the matter of protecting the surety, see Section 76.

men are thought to have left a large estate practically free from debt, it happens that a large number of creditors appear and the estate turns out to be insolvent, or so nearly so that it is necessary for the creditors to look to the real estate for payment.

It is suggested therefore that as a general proposition, collateral security should be required, and that, while there may be cases where collateral is not absolutely necessary, great care and caution should be exercised and the condition of the estate of the decedent should be carefully investigated to ascertain whether or not the personal property is very much in excess of any debts that may possibly arise.

Sec. 97.—**Bond of Legatee to Pay Debts of Testator.** In some of the states, the law provides that the legatees under a will, immediately upon the death of the testator, may take possession of the estate bequeathed to them, upon the giving of a bond conditioned for the payment of all debts to which the estate may be subject. In that event it is not necessary to probate the will or administer the estate. Such bonds have generally been construed to guarantee the payment of the debts of the testator, regardless of the value of the estate received by the legatees. In other words, when a legatee, instead of going through the usual process of administration, which would give him full protection, elects to take immediate possession and ownership of the estate and gives the required bond, he and his surety absolutely guarantee the payment of all the debts against the estate, regardless of whether the estate so received is sufficient for that purpose or not.

The risks under such a bond are:—(1) that the legatee will squander or secrete the estate and put it out of his power to pay any debts that may arise, and (2) that, even if he retains the estate to pay possible debts, the debts may exceed the estate, so that if he has no other property, the loss will fall on the surety, for all debts must be paid.

There are necessarily few, if any, cases where a surety would be justified in assuming that there are no debts; and to the extent that there are debts, the bond is a credit guarantee, requiring collateral security.[1] In estimating possible debts, each case must of course depend upon its own circumstances; but attention is directed to the numerous cases in which deceased persons are found to owe more than is shown by their books; as for example, where they are surety or endorser for others. The importance of putting a very liberal estimate on the possible debts is not to be underestimated; indeed, it would seem that the full penalty of the bond is the only safe estimate. It is possible in some cases to get joint control of the assets; and in that event, the only chance of loss would be in case the debts should exceed the assets.

Sec. 98.—**Fiduciaries as Applicants for Bond in Judicial Proceedings.** A fiduciary often desires to apply for an attachment, injunction, replevin or other judicial process, believing it will aid him in the collection of a debt due the estate, or in the recovery of property belonging to it. In order to have the process

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[1]See Section 76.

issued, he must, like any other applicant, give the usual bond. The general rule is that, if the fiduciary is properly authorized and *directed* to apply for the process, and if he prosecutes the action in good faith and with diligence, and does not exceed the authority and direction of the court, then any incidental expense, including any liability on the bond, would be considered an expense of administration and would be paid before any distribution to the creditors or other persons. It might seem therefore that the chance of loss by the surety on such a bond would be small, it being assumed that nearly all estates in the hands of the fiduciaries have enough assets to pay the expenses of administration. It has been found however, that such bonds are not altogether desirable, but on the contrary are rather dangerous risks. The following dangers, among others, may be mentioned.

1. The Court, in making the order directing the institution of the proceedings, may be exceeding its jurisdiction; and the order may, in consequence, be void. This is likely to be the case with probate courts, or other courts with only limited statutory jurisdiction.

2. The fiduciary may exceed the authority conferred upon him by the court having jurisdiction, or he may be negligent, or act in bad faith, and in consequence, the liability under the bond may be held to be a *personal* liability which cannot be enforced against the estate.

3. There may not be sufficient assets in the estate to pay the expenses of administration, as those expenses

often exceed the expected amount, and the assets often turn out to be less than was anticipated.

4. It may be that the fiduciary not anticipating any liability under the bond, will distribute or otherwise dispose of the assets of the estate before the liability or the bond accrues.

5. The fiduciary may squander the assets; and even if he has a good surety, a suit may be necessary, and that always means expense and possible defeat.

Even if the fiduciary should deposit with the surety enough of the assets to cover the liability, the surety would not necessarily be protected. Although that would protect the surety against an insufficiency of assets, yet, if the court, in making the order, exceeded its jurisdiction, or if the fiduciary should exceed the authority given him by the court, or if he should be negligent or act in bad faith, so that the liability for the wrongful attachment or other process would be held to be a *personal* liability, for which the estate is not liable, then no doubt the surety could be compelled to return the portion of the assets received as collateral and would not be permitted to use them in satisfaction of the liability under the bond.

It would seem therefore that in order to make such bonds *perfectly* safe, it would be necessary to obtain as collateral something other than the assets of the estate. However, where the court giving the direction to institute the proceeding is a court of chancery, having general jurisdiction; where the order gives the fiduciary *full* authority and *direction* to apply for the process;

and gives him authority to do whatever he may deem to be incidentally necessary or expedient; and authorizes him to apply to a surety company for the necessary bond, and to deposit with the surety company a part of assets as collateral security, then it may be reasonably safe to accept, as collateral, a part of the assets of the estate.

Sec. 99.—**Municipalities as Applicants for Bond in Judicial Proceedings.** It might seem, on first thought, that appeal, attachment, injunction, replevin and other court bonds might be executed for counties and cities without danger of loss, it being assumed that there is very little, if any, possibility that such a municipality will become insolvent and unable to pay its debts. It has been found, however, that such bonds are often very undesirable for one or more of several reasons.

First, when the surety seeks reimbursement from the municipality, it may be contended, as was done in a case in North Carolina, that the municipality had no authority to execute the bond, nor to execute the indemnity bond to the surety, and therefore that the surety can not secure reimbursement from the municipality for any amount it may have paid.

Second, the debt secured by the bond may be such as the municipality has no right under its charter to incur, or may be in excess of the indebtedness which it can legally incur.

Third, although the liability may be admitted, yet there may be in the treasury no funds with which the payment can be made; and the surety may be compelled

to pay the liability under the bond and await the pleasure of the city officials in making the necessary levy and reimbursing the surety. This very thing happened in the case of an appeal bond executed by a surety company for the city of Chicago; and the surety company had to wait several years for its money notwithstanding there was a final judgment against the city. The business, under those circumstances, was necessarily unprofitable, although there was no loss in the sense in which that term is ordinarily understood. In a certain western town, the officials refused to make a levy for the purpose of paying a debt of the town, and even went to jail and served a term for contempt of court in refusing to obey the order of the court in a mandamus proceeding instituted to compel a levy and payment.

In view of these facts, it would seem advisable to require collateral security on all bonds for counties and municipalities; and furthermore, it ought to be ascertained that the obligation to be secured by the bond is one which the municipality has a legal right to incur, and that the funds or securities put up as collateral had been properly appropriated to that purpose; otherwise the surety may be compelled to return the collateral without being able to reimburse itself.

CHAPTER V.

CONTRACT BONDS.

Sec. 100.—**Scope.** Nowadays nearly all contractors are required to give bond with corporate surety for the faithful performance of their contracts; and those bonds form one of the largest, and at the same time, one of the most hazardous classes handled by surety companies. Bonds may be required for the performance of any kind of contract, and all such bonds are within the scope of this chapter, yet bonds for building or construction contracts are the kind most frequently needed, and with which we are principally concerned.

In connection with a contract, three different bonds may be required, namely: the preliminary or bid bond which guarantees that if the contract is awarded to the principal, he will sign the contract and give bond for its faithful performance; the construction bond, which guarantees performance of the contract; and the maintenance bond, which guarantees the durability or efficiency of the work. In some cases, a separate bond to guarantee the payment of bills for labor and materials is required; but that liability is generally covered by the construction bond and will be discussed under that head.

Sec. 101.—**The Underwriting of Bid Bonds.** In case the principal in a preliminary or bid bond should fail to comply with the condition of the bond, the owner will award the contract to the next higher responsible bidder, or if there is none such, will re-advertise the

contract. The maximum actual liability therefore will be the difference between the bid of the principal and that of the lowest acceptable bidder other than the principal; but in order that application for these bonds may be acceptable, it is not enough that the applicant has sufficient resources to stand this difference. It is considered bad policy for a surety company to sign the bid bond unless it is also willing to sign the construction bond. The premium is nominal, so that nothing would be gained and much might be lost. And it is also bad policy to issue the bid bond on the assumption that an investigation to be made thereafter will prove satisfactory, as the surety may find itself practically compelled to sign a bond for an unsatisfactory contractor. As a rule therefore, preliminary or bid bonds should be issued only where the company is willing to sign the construction bond in case the contract should be awarded to the principal.

Sec. 102.—**The Underwriting of Construction Bonds.** We now come to the consideration of what is ordinarily termed a contract bond, viz: the bond guaranteeing the performance by the principal of the terms of a contract for the construction of a building or other work. In considering the underwriting of such bonds, we will follow the plan that has already been adopted of treating the subject from the two standpoints of the personality of the contractor and the character of the contract.

Sec. 103.—**The Personality of the Contractor. In general.** A contract bond is broader than a fidelity

bond. The latter is of a negative nature, guaranteeing merely that the principal will not commit certain specified acts. The former, on the other hand, is positive, guaranteeing that the principal will perform his contract. If an employee is honest, it is practically certain that his surety will not suffer a loss; but a contractor may be perfectly honest, yet may be deficient in ability, experience or financial resources to carry out the particular contract; and therefore, his surety may suffer a loss, notwithstanding his honesty. It is necessary therefore to consider the personality of the contractor from the following standpoints: his personal honesty and good intentions; his ability and experience to do the particular work; his plant and equipment; his financial resources; and the amount of work he has on hand.

Sec. 104.—**Honesty and Good Intentions.** It is not necessary or practicable to investigate the matter of the personal honesty of a contractor with the same scrupulous care that an applicant for a fidelity bond should be investigated. It is however necessary to be satisfied that he is a *bona fide* contractor, who intends to carry out his contract to the limit of his ability and resources; that he is a man of reasonably good personal habits, and particularly that he does not drink to excess; that he has been in the habit of performing his contracts satisfactorily, and paying his bills promptly, and that he bears a good reputation for honesty and integrity in the community in which he lives and with those for whom he has done work. And the importance of ascertaining these matters is not to be underestimated. Contract

bonds are very hazardous and contractors should be carefully investigated from every standpoint. In this connection it is to be borne in mind that the statements of the men from whom the contractor has been purchasing his material and supplies are not always reliable. It has been found that when a contractor is heavily indebted to a dealer, the latter will often recommend him in order that the contractor may, out of the proceeds from the new contract, collect the amount due him. Before relying upon a reference from a dealer, it ought to be ascertained that the contractor does not owe him an excessive amount, and that the bill is not overdue. Architects, engineers and owners for whom the contractor has done work in the past can give the most reliable information, and whenever possible they should be consulted.

Sec. 105.—**Ability and Experience.** There is such keen competition among contractors, and the successful ones work with such facility and economy, that there is little chance for the man who is not up to standard in ability and experience. A contractor must be able, not only to perform the work successfully but to estimate the cost accurately. If an inexperienced contractor meets competition in bidding, he will either make little, if any, profit, or will sustain a loss; and the surety for such a contractor is in constant danger of loss, even though the principal may seem to have ample financial resources.

In the first place, there is the man who has really no experience as a builder, but who, as a carpenter or

sub-contractor, has acquired a few hundred, or perhaps a few thousand dollars of capital, and with that and a lot of nerve, sets himself up as a "contractor and builder," or as a "general contractor." He will usually be satisfied to take contracts for ordinary residences, where he thinks no especial skill or experience is required; but having no reputation as a builder, he can get work only in competition with experienced contractors. In such cases, where bids are asked indiscriminately, competition is usually keen; and, in order for him to get the contract he must make a very low bid, and will therefore have to do the work economically. If therefore, the particular contractor has not the experience and ability necessary for the most economical work, he will not make a profit and may sustain a loss. When such a "contractor and builder" takes a contract, and before it is completed, gets others, he is apt to become so involved in debt that he cannot extricate himself, with the result that the loss falls on the surety. There are in fact many such cases among the records of surety companies and it has been found that the percentage of losses on account of these contractors is very large. Lack of experience and ability is generally shown in one or more of the following particulars:

1. He is likely to underestimate the overhead and incidental expense necessary in carrying on business operations. He generally gets bids on the several portions of the work, takes the lowest bid on each portion, adds them together and considers that the cost of the building. He allows nothing for the contingency that

the low bidder, who in all probability has no financial responsibility, may not complete the work at the figure for which he bid; and allows nothing for the many other contingencies that may arise and make the work more expensive than he has calculated.

2. He will figure very close on certain portions of the work because he thinks he can do some of it himself and thereby save expense.

3. Mistakes in estimates are apt to occur because, while large contractors have their figures checked by two or three different men, the small contractor relies solely on his own calculation.

4. It is seldom that such a man manages the work in an efficient manner. It really takes considerable executive ability to carry out in an economical manner even a small contract; and there are few of these small contractors who have that particular kind of ability, which can be acquired only by experience. They are likely to make costly mistakes and their men do not always work to the best advantage.

5. Many of these small contractors know absolutely nothing about bookkeeping and often keep no books at all. The result is that they cannot tell whether the work is profitable or how they stand financially. They simply go ahead with contract after contract, using the money from one to pay bills on the others, until finally they are forced into bankruptcy.

The only solution of the problem of these inefficient contractors is for the surety companies to decline to bond them; but it seems possible, with the large num-

ber of surety companies and all the agents competing for business, for almost anybody who calls himself a contractor to get a bond. There are other dangers incident to bonding these small contractors, and those dangers will be referred to in the proper places.

Lack of experience has also been noted in large contractors who undertake lines of work with which they are not familiar. There are specialists in the contracting business as there are in other lines of business and the professions; and, though a man may have ample experience in one branch, he is not necessarily qualified in others. And, if a man who is not experienced in a particular branch undertakes to compete with those who are, the result is likely to be disastrous to his surety as well as to himself. A man may, for example, be a good builder of ordinary frame or brick houses, yet not competent to build a monolithic concrete residence or a warehouse with reinforced concrete frame; or he may be competent to build almost any kind of house, yet not be competent to build a railroad or a sewerage system. It is important, therefore, to ascertain that an applicant for a contract bond is qualified by experience and ability to do the particular work in hand and to estimate accurately the cost. Inquiry ought to be made of architects, engineers and owners for whom he has done work similar to that in question, and unless their opinion is favorable, the business is generally undesirable. If he has not had experience in similar work, then he should not be bonded unless he has ample financial resources to pay for his mistakes. Attention

is directed to the difficulties not only of doing, but of accurately estimating the cost of certain classes of work; as for example, the building of sewers, subways, tunnels, waterworks and dams, and dredging, where unforeseen difficulties, making the work extra-expensive, are likely to be encountered.[1]

Sec. 106.—**Plant and Equipment.** In order that a contractor, may successfully perform his contracts, it is necessary that he should have the teams, machinery, tools and other equipment necessary for economical work. It is important to ascertain that the equipment is modern and in good condition; for many losses have been caused by the fact that the jobs have been started with worn-out or inefficient machinery or equipment, necessitating much delay and expense for repairs and oftentimes the purchasing or hiring of other machinery before the completion of the work. Where the work is at all difficult or requires the use of much machinery, the contractor ought to be required to give a detailed description of his plant so that it may be submitted to the company's engineer for approval. The engineer having the work in charge generally makes himself familiar with this matter and can give valuable information. So also can engineers for whom the contractor has done similar work.

The foregoing remarks apply more particularly to large contractors doing difficult work, but it is also necessary for small contractors to have a plant. Any contractor worthy the name ought to have not only the

[1] See Section 107, third paragraph.

usual teams and tools, but he ought also to have an office with a good stenographer and bookkeeper. The contractor who transacts his business on the street and keeps his accounts in his head, does not deserve to get a bond; yet, there are many such contractors who seem to be able to get bonds without much difficulty. It is of prime importance that a contractor should be able to tell exactly whether his work is profitable and what his financial condition is at any particular time; and if he cannot do this he is not a safe man to bond. In general, it may be said that the man who has not an office, with a complete set of books and somebody to keep them, should be let alone by the bonding companies.

Sec. 107.—**Financial Resources.** We come now to what is perhaps the most vital element in the making of an acceptable contractor. A man may be honest and he may have sufficient ability, experience and equipment to do a particular work but if he has not sufficient money to provide the necessary labor and materials and to take care of a possible loss of reasonable amount, he is not a desirable risk.

It is not possible to make a rule, applicable to all cases, as to the amount of money a contractor ought to have to justify a surety company in signing his bond. That will depend upon a consideration of all the other elements that go to make a contractor. But experience has shown that, even if a contractor is a desirable risk in other respects, he ought to have on hand, in money or in good assets on which money can be immediately realized, an absolute minimum of fifteen per cent. of the

total amount of all his contracts.[1] And it is only with the highest grade of contractors that such a small amount is permissible; eighteen or twenty per cent. would perhaps be a better average minimum; and in many cases, a larger amount will be necessary to make up for the deficiencies in other respects. This minimum is necessary not only to finance the work but to take care of the ever-present danger that the work will cost more than the contract price; and therefore the minimum ought to be had after all necessary equipment has been provided and paid for,—unless, of course, the cost of the equipment has been figured in the estimate.

In cases of contracts for sewers, subways, tunnels, waterworks, dams, dredging and the like, where the work is in its nature essentially hazardous, that is, where unforeseen difficulties, making the work extra expensive, are likely to arise, it is especially necessary that the contractor have ample financial resources. In such cases, it is suggested that the contractor ought to have financial resources equal to at least 20% of the contract price.

The difficulty, however, is not to determine what financial resources a contractor ought to have, but to determine what assets he has and what those assets are worth as *financial* resources; that is to say, what amount of money can be realized on them to carry on the work and to take care of the loss.

A contractor's assets generally consist of cash, stocks and bonds, real estate, equipment, supplies and

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[1] See Section 108.

accounts receivable. In order that it may be determined that an applicant has what he says he has, he ought in the first place to be required to sign a letter addressed to the bank in which the cash is supposed to be deposited, requesting the bank to give the company full information concerning the state of the applicant's account and of his dealings with the bank. Then the surety's representative ought to talk with the officials of the bank and ascertain not only that the applicant has in the bank what he says he has, but also, his average balance and his standing at the bank, particularly his ability to borrow from the bank. Money that is not in a bank but supposed to be at the home of the applicant is usually imaginary, and should not be considered.

The stocks and bonds ought to be exhibited to the surety's representative, and wherever practicable, they ought to be deposited in a safe deposit box subject to the joint control of the surety so that they may be used for the purpose of carrying out the contracts and for no other purpose.

It may be difficult or troublesome to verify the ownership of real estate, but it is not impossible, and inasmuch as surety companies have so often been deceived by false statements as to the ownership of real estate, the matter should not be neglected. The first thing is to require the applicant to give the exact location of the property, and to state when and from whom it was purchased, or how it was acquired. It will then be an easy matter to go to the land records, examine the

indexes and see if the supposed deeds are on record and if the property stands in the name of the applicant. If it is found that the property has been conveyed to him, then the indexes should be followed down to date to see if he has disposed of it or mortgaged it. It does not take a lawyer to do this. A few inquiries from the recorder, or one of his clerks, will enable the average man to follow the above suggestions; and, if followed, they will be found to be of the greatest service in discovering those who are attempting to deceive the company and get bonds to which they are not entitled. If the property is supposed to have been acquired by inheritance, a few inquiries at the office of the clerk of the Probate Court will generally bring to light a list of the real estate of decedent as well as the names of his heirs. If in fact the property was thus acquired, the land records should be examined for conveyances and mortgages by the applicant. It is at least possible to examine the tax assessment roll, and if the property does not appear to be assessed to the applicant, an explanation should be required.

As far as the accounts receivable are concerned, the applicant should be required to give a list of them, with the persons or corporations from whom they are due, and give such other information as will enable the surety's representative to ascertain all the facts with regard to them; and this information should be obtained.

Where the applicant keeps a good set of books and there is no evidence that they have been falsified, considerable dependence can be put in them; and, where-

ever practicable, they should be examined. On the other hand, where the applicant keeps no books, or keeps an imperfect set and makes up his financial statement from memory, it is strictly important to verify each item. A detailed report from the mercantile agencies should, of course, be obtained. They are fairly reliable, but surety companies have so often been deceived by inflated financial statements that further investigation along the lines above indicated is deemed necessary.

Having ascertained that the applicant has all the assets shown in his financial statement, it is next in order to give them their proper value. It is to be borne in mind that we are now considering a contractor from the standpoint of his ability to carry on the work and to take care of a possible loss; and it follows that the assets can be considered as valuable only to the extent that they can be converted into cash, either by sale or pledge, and to the extent that they can be applied to the liquidation of any liability under the bond.

The stocks and bonds should, therefore, be rated at their actual market value. If they are not quoted on the stock exchange, due allowance should be made for the probable difficulties in finding a purchaser at what might be considered their fair value, based upon income.

The real estate should be rated at its probable value at a forced sale. If it is improved city property in a good location, it would probably bring at forced sale about 70% of what might be considered its actual value

based upon cost. If it is country property or unimproved property, whether in the city or country, it would probably not bring more than 50% or 60% of its value. The amount of any mortgages or incumbrances should be deducted from that valuation. Indeed, if property is mortgaged for a substantial sum—as much as 50% of its supposed value—it is of little or no practical value in case of a default, and should not be considered an asset. Where the property is exempt from execution as a homestead, or where it stands in the name of the applicant's wife, or in the joint names of himself and wife, so that it is not subject to execution for his debts, it should likewise not be considered an asset. It is generally difficult to verify the ownership or value of country property; and unless there is definite and satisfactory information on both of these points, it is generally wise to ignore such property, especially if it is far from the home of the applicant and unimproved.

The equipment may be very useful and necessary in carrying on the work, but generally represents little, if any, borrowing power and can be sold only at a very liberal discount. Due allowance, considering the age and usefulness of the equipment, should be made. Equipment of this kind can seldom be sold for more than half its cost, and often not for that.

The accounts receivable ought to be separated into two classes: those *actually due and receivable at the time,* and those to become due in the future. If the former are due from responsible parties they may be

taken for their face value, or say 90% of face value. In investigating the latter class, it will often be found that the amount is disputed, or that it is necessary for the contractor to do certain work, or to wait a considerable time before he can get the money. All such matters affect materially the usefulness of the accounts for the purposes of the contract and due allowance should be made. If there is a dispute as to whether or not the money is owed, or if the parties who owe the accounts are not financially responsible or if payment will be deferred for a long time, or if there is any other thing that may prevent the contractor from receiving the money promptly, the items should be eliminated.

In this connection attention is directed to the importance of having the financial statement made up at a time when the contractor has little or no work on hand, as otherwise it may not reveal his true condition. If he has other contracts on hand, his statement will not necessarily show his true condition; for while his cash and accounts receivable may, at a particular time, be in excess of his accounts then *actually due* and payable, he may nevertheless have a large volume of outstanding bills not yet due, and in fact, may not be able to complete the pending work for the contract price, and may therefore be behind when he seems to be ahead. It has often been found that a contractor, realizing that he will sustain a loss on a particular contract, will make a special effort to obtain other work in the same neighborhood in the hope of recouping his loss, or at least deferring his failure in the hope of future profits. And

it has been found that although he made an accurate statement of his accounts receivable and accounts actually due and payable, and that, although his statement showed him to have ample resources, yet as a matter of fact, he was then practically insolvent.

While it is necessary to have a correct statement of accounts actually due to the contractor and of those due by him in order to determine his *available* cash resources; yet it is necessary, in order to determine his *real* financial condition, to ascertain whether the balance to be received from the pending contracts, plus cash on hand, will be sufficient to complete the contracts and pay all outstanding bills, whether they happen to be then due or not, and leave a surplus. It is really only the surplus that constitutes the worth of the contractor. And inasmuch as *estimation* is necessary to arrive at a conclusion, a liberal allowance should be made for contingencies. It is a good idea never to allow a supposed profit on a contract to *increase* the contractor's assets. Investigation in this direction is to be made to see if his statement of current assets is to be *decreased.*

It is hardly necessary to add that the liabilities of a contractor should be carefully considered; as they often indicate the weakness of his financial condition when it might otherwise seem to be good. One of the things especially to be borne in mind, is to see that he has ample resources in the shape of cash or good accounts receivable to take care of current liabilities, whether for borrowed money or for goods purchased. In other words, available quick assets must exceed cur-

rent liabilities, regardless of the value of real estate and other slow assets. In general it may be said that when a contractor has a large proportion of bills payable and accounts payable, it is a sign that he may be doing too much work for his resources, and that he should be carefully investigated. The fact that he has put a mortgage on his real state may be a sign that his borrowing capacity is limited; and if he has been compelled to put a chattel mortgage on his equipment, it is generally a sign that he is pretty weak, and that it were better not to bond him.

In suggesting that financial statements of contractors be verified, I am not unmindful of the possibility that the applicant will resent a suggestion that it is deemed necessary to verify his statement. There may be some perfectly honest men who would resent such a suggestion, as an aspersion upon their integrity; but generally only those who have made false statements are fearful of such an investigation. The experience of the companies is that where the statements are not verified, the assets often prove, in event of default by the contractor, to be fictitious. One company reports that, in making a partial examination into the causes of its losses during the year 1912, it found a loss of more than $37,000.00 directly attributable to false financial statements of principals. The president of this company says, "False financial statements still rob our treasury of enormous sums." The rule ought to be, and no doubt will sooner or later come to be, universal, that only those assets that can be verified both as to their exist-

ence and their value, will be considered in estimating the financial resources of a contractor. There is exactly the same reason for verifying the financial statement of an applicant for a contract bond as there is for investigating the past record of an applicant for a fidelity bond. We do not accept the statements of the latter. Why should we accept the statements of the former? It is a business proposition in which sentiment has no place.

Sec. 108.—**The Amount of Work on Hand.** A man may be capable of building, economically, a certain style of house and making a profit at current prices; yet, if at one time he undertakes the construction of half a dozen such houses in different localties, where he cannot give his personal attention to each, the increased expense resulting from the lack of close personal supervision, may be such as to wipe out his profit or cause a loss. Then, too, when a small contractor gets a large amount of work on hand, his accounts usually become so involved that it is difficult to find out exactly where he stands; he may think he is making profit when he is not. It is important therefore to see that a contractor does not "outgrow his strength." Assuming that he is honest and personally efficient, the amount of work he can safely carry on will depend principally upon his financial resources and the efficiency of his organization[1] Large contractors, who have an efficient organization, and who are in the habit of sub-letting large parts of the work and requiring their sub-contractors to give

[1] See two preceding Sections.

bond with corporate surety, can successfully carry on work equal to eight or ten times the amount of their net resources. The principal danger is from the small contractor, who, because he handles a few contracts successfully, wants to grab everything in sight and at once become a "big contractor." Such men, even where they fully measure up in other respects, should not be permitted to carry more than about six times the amount of their net available assets.

Sec. 109.—**The Nature of the Contract.** As we have already seen, the question whether or not a contractor can perform a particular kind of work will depend upon his ability, experience, equipment and financial resources. However, he may be able to do that work under some conditions, but not under others; and his success or failure may depend largely upon the terms of the contract and the conditions under which the work must be done. It will be the object of the succeeding pages to indicate some of the dangers that may result from the terms of the contract, it being understood that we shall not deal with the difficulties of doing different kinds of *work*. That matter will depend upon the ability, experience, resources, etc., of the applicant, and has already been considered.[1]

Sec. 110.—**Adequacy of Contract Price.** There is always a possibility that a contractor will not be able to do the work for the contract price. Such inability may result from causes that could not reasonably have been foreseen, or from the inefficiency of the contractor, or

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[1]See Sections 105-108.

from the fact that the price is too low,—so low that the most efficient contractor could not do the work for the stipulated price. Theoretically, the contractor's assets will protect the surety against unforeseen dangers; and, as we have seen, inefficient contractors should not be bonded. But surety companies must also guard against the case where the price is really too low. This is essentially important, for many losses have resulted from this fact. One company reports that in making a partial examination into the causes of its losses during the year 1912, it found that, in the cases examined, nearly $65,000.00 was directly attributable to the fact that the principal's bid was too low.

In case the contract is awarded to a particular contractor, without competitive bidding, about the best it is practicable to do is to compare the contract price with the estimate of the architect or engineer. If that comparison is favorable, it may fairly be assumed that the price is commensurate with the work. A man who has sufficient reputation and standing to get contracts without competition usually has enough experience and ability to estimate the cost of the work with reasonable accuracy, and common sense enough not to undertake the work for an inadequate price.

If, however, it is a case of competitive bidding, the greatest care should be exercised to obtain the names of the other bidders and the correct amounts of their respective bids. This information can generally be gotten from the owner or architect. If other reputable contractors have bid only a little more than the suc-

cessful bidder, the difference may be ascribed to the natural differences in different calculations; but if the successful bidder is much below the others, it is a sign that an error of some kind probably has been made, and that the bid is not commensurate with the work. And it is not always sufficient to compare the bid of the successful bidder with that of the next higher man, for he likewise may be in error. The comparison should rather be made with the general average of all bids. It is difficult to state what percentage of difference would be the probable result of different calculations, and what, a sign of error; for circumstances alter cases. In general, it may be said that a difference of five per cent. would not ordinarily be a cause for alarm, but that one of ten per cent. would be a sign of error. And, in the latter event, the bond should not be signed unless the contractor is so strong financially and of such splendid reputation that he undoubtedly could and would stand a loss of that amount, plus the possible loss from unforeseen calamities. Likewise, any difference between five and ten per cent. should be a warning, and care should be taken to see that the contractor is able and willing to take care of the possible loss.

As a general proposition, it will make little difference whether the contract is considered as a whole, and a definite price, in the aggregate, provided for all the work, or whether the contract is divided into a number of units, and a definite price provided for each unit. It is about as easy to calculate the cost in the one case as in the other, so the chance that the cost will exceed

the estimate is practically the same in both cases. But contracts are sometimes let on the "percentage basis," which means that the contractor agrees to do the work for cost plus a percentage,—the percentage being compensation for the skill, experience, equipment, etc., of the contractor. This eliminates, to a certain extent, the speculative feature, and such contracts are more desirable, from a standpoint of the surety, than the ordinary contract, under which the contractor takes the risk of the cost exceeding the contract price. As a rule, such contracts are awarded only to the most efficient contractors; and, unless the percentage is so small as to be unremunerative, it is fair to assume that the contractor will complete the contract. The dangerous feature about such contracts is that the contractor is generally required to guarantee that the work will not cost, in the aggregate, more than a specified sum; and, if it exceeds that sum, he is required to stand the difference. It is very important therefore to ascertain that the amount of the guarantee is well beyond a liberal estimate of the cost. The real risk of the surety is in proportion to the possibility or probability that the cost will exceed the guarantee. If it is a case of competitive bidding, the amount of the other guarantees should be obtained and a comparison as above indicated should be made.

Sec. 111.—**The Payment of the Price.** A prospective surety ought to know not only that the price is adequate, but that it is to be paid in a satisfactory manner.

In the first place, although calculations are gen-

erally based upon a price in money, it often happens that the contract provides for the giving of stocks, bonds, notes or other securities in payment for the work. In such cases, the risk ought not to be accepted unless sufficient securities are to be received to yield immediately, in money, the estimated cost of the work plus the profit; and the contractor ought to have a binding contract by which he can immediately dispose of the securities at a price that will yield that sum. This matter of disposing of the securities should not be left to chance or speculation, but a definite arrangement with a responsible concern should be made in advance; and this arrangement should not be conditioned upon the validity of any issue of bonds, or upon any other matter. All such questions should be determined in advance; and the arrangement should be absolute, so that the expected amount of cash can, under any circumstances, be immediately realized. If the surety should be compelled to complete the contract, he would not relish doing so for a lot of securities of doubtful value.

In the second place, it is important that a proper percentage of the contract price—neither too much nor too little—be retained by the owner until completion. Enough must be paid during progress to enable the contractor, with the aid of his resources, to finance the work; that is, to provide the necessary labor and materials. At the same time, it is to be borne in mind that the percentage to be retained will, in the event of default by the contractor, be available for completing

the work, and is therefore a margin of safety for the surety,—the margin being in proportion to the amount retained.

Some building contracts provide for the payment of a certain percentage of estimates to be made periodically by the architect or engineer in charge; the percentage varying from about seventy-five to ninety. Others provide for the payment of stipulated sums when the work has progressed to stipulated points. Any such arrangement may be satisfactory, so long as the contractor never, at any time during progress, receives the full value of the work done; it being always understood that the greater the retained percentage, the smaller the chance of loss, *provided* enough is paid to relieve the contractor of embarrassment in financing the job.

Sec. 112.—**Time for Completion.** No matter how efficient a contractor's organization may be, it takes time to erect buildings and other works; and before signing a contract bond, the surety ought to ascertain that the contract gives ample time to do the work and that provision is made for an automatic extension of the time in case the contractor should be delayed by causes beyond his control; as for example, by a general strike in the trade, by fire, tornado, or bad weather. This is essentially important and should never be overlooked; for, in many cases where there is a dispute growing out of a delay, the delay is the result of circumstances beyond the contractor's control. All such

disputes could be avoided by making a proper provision in the contract or bond.[1]

In many cases, the contract provides for the payment of a definite sum of money daily as liquidated damages for delay, and care should be taken to ascertain that this sum is not exorbitant but represents the approximate amount of damages that will actually be sustained by the delay. It is not fair for the owner to make a profit out of the contractor's delay; all the contractor and his surety ought to be asked to do is to pay the actual damages suffered. The true amount of damages will ordinarily be the fair net rental value of the premises; and the amount named in the contract should not exceed that sum.

Sec. 113.—**Liability in case of Destruction of Building by Fire, or Other Cause During Construction.** It is the law of most of the states that in the absence of an express provision, a contractor is not released from his obligation to complete a building by the destruction of that building during construction, even by causes beyond his control, as for example, by fire. The surety on a contractor's bond does not, however, contemplate such a risk,—so it is necessary to ascertain, either that the contract or the bond exempts the contractor from such responsibility,[1] or that adequate insurance is taken out, payable to the owner and contractor, as their interests may appear.

Sec. 114.—**Liability for Personal Injuries.** A Contractor is likely to be compelled to respond in damages

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[1]See Section 116.

for personal injuries sustained by employees or other persons in the course of the construction of the work covered by the contract. A number of the states have recently enacted workmen's compensation laws, which provide for a very strict liability on the part of contractors and other employers who are engaged in hazardous undertakings. These laws generally provide that the employer shall be liable to the employee regardless of the question of negligence on the part of himself or his employees. As a rule the surety on the contractor's bond is not directly liable for injuries to employees, yet the payment of such damages by the contractor would to that extent reduce the contractor's ability to complete the contracts on hand and take care of possible losses; and all contractors should protect themselves against this liability by taking out employer's liability insurance in an adequate amount and in a recognized company, and this is especially necessary in those states where the employer's liability or workmen's compensation acts have been recently passed. It is suggested that all contractors, though they may be doing only a small amount of work and that of a comparatively simple character, be required to carry liability insurance.

In the case of an injury to a person not an employee, the owner as well as the contractor may be held liable for damages; and under many contracts and bonds the surety would be compelled to reimburse the owner for the loss. In such cases therefore, in the event of the contractor's insolvency, the surety may be liable not only to complete the contract but also to respond in

damages for personal injuries. If the contract and bond provide for this liability on the part of the surety, the bond should in no event be signed unless the contractor is fully protected by public liability insurance. It is the duty of underwriters to look carefully into this matter of employers' and public liability insurance, as liability for accidents is becoming a very serious matter.

Sec. 115.—**Liability of Surety for Labor and Materials.** In order to satisfy the obligation of his surety, a contractor must, in the majority of cases, not only complete the work covered by his contract but he must also pay for all labor and materials that may have been used in carrying on the work; otherwise his surety may be compelled to pay for them. Indeed, the most frequent element of default on the part of contractors is, not in failing to complete the work, but in failing to pay for labor and materials.

The liability of the surety arises in this way: nearly all of the states have made provisions by which those who have done work and furnished materials to contractors may, to a greater or less extent and upon certain conditions, file a lien, commonly known as a mechanic's lien, against the property for the erection of which the materials were furnished, and recover from the owner the amount left unpaid by the contractor. Consequently, the owner generally requires of the contractor a bond conditioned not only to complete the work but to protect him against liability for labor and materials furnished to the contractor. In some cases, however, a contractor is required by law to give a bond

which contains a direct obligation to pay all bills for labor and materials, and under which laborers and furnishers of material have a right of action directly against the surety.

The underlying principle of mechanic's liens is that a man ought not to be permitted to have the benefit of the labor or material of another without paying for it. Where the owner of the property orders the materials, the application of the principle is quite simple, but where the work is let to a contractor and he orders the labor and material, the matter is more complicated; for the owner may, in effect, be required to pay for the materials twice,—once to the contractor and again to the furnisher. The difficulty in applying the principle has resulted in different laws in the different states with little or no uniformity, although with some similarity.

There are at least three different aspects in which this subject is presented.

First: As a general rule, public property, that is to say, property belonging to the United States, or a state, a county or a city, is not subject to mechanic's liens; and a statute which provides in general terms for such liens is not ordinarily construed to provide for a lien on public property. In order that those who furnish labor and material for public work may have the right to a lien on the property, or to recover from the contractor's surety, there must be a statute which in express terms gives such right. There are, however, a number of such statutes. An Act of Congress pro-

vides that one who contracts with the United States shall execute the usual penal bond, with the additional obligation that the contractor shall promptly make payments to all persons supplying him labor and materials in the prosecution of the work provided for in the contract. The persons supplying labor and material are given a right of action under the bond directly against the surety, and are not required to establish any lien by filing a claim. A similar law exists in some of the States with respect to contracts for public work. In some cases, a separate bond is required, and in others, the additional obligation is contained in the regular contract bond. Where such direct liability exists, a breach of the contract on the part of the owner (such as an overpayment to the contractor, or a material change in the contract) would not affect the liability of the surety, so far as the payment for labor and materials is concerned; and since there are no details as to giving notice, filing claims, etc., which the claimant may omit to perform, it is fair to assume that, where such direct liability exists, the surety will be compelled to pay every bill which the contractor fails to pay.

Second: In the case of contracts for private work, there are two principal classes of laws. One class, which follows what is known as the Pennsylvania rule, provides that the laborers and furnishers of material shall have a lien on the building and the land on which it stands for whatever may be due them for labor and materials furnished for the work. In order to perfect

such a lien, they must generally file in some court, within the time and in the manner required by law, a detailed statement of their claims. In some cases the lien may be enforced in an action directly against the surety, but in most states, the lien is enforced only against the property and its owner, and the owner is left to his remedy against the surety. The fact that it is necessary for a claimant to perfect his lien by filing his claim within a certain time and in a certain manner and form sometimes operates to relieve the surety from liability; for it sometimes happens that a claimant does not perfect his lien, either because a lien for the particular labor or materials cannot be had, or because he did not suspect, until too late, that the contractor would fail to pay, or because of some negligence on the part of himself or his agents.[1]

[1]The Pennsylvania rule is in force in the following States:

ARKANSAS.—Kirby's Digest of 1904. Secs. 4970-75. Sec. 4975. which limited the liability of the owner, was repealed by Sec. 6 of Act 446 of Acts, 1911.

CALIFORNIA.—Code C. P., Secs. 1183-84, as amended by Act, 1911, Ch. 681. Claimants have a right of action directly against the surety.

DELAWARE.—Rev. Code, as amended 1893, p. 818, being Ch. 145, Vol. 16, Laws Del.

GEORGIA.—Code, Secs. 3352-3.

IDAHO.—Code C. P., 1909, Sec. 5115.

INDIANA.—Burns Anno. Statutes, Sec. 8295 et. seq., Ch. 116, Acts 1909.

LOUISIANA—Act 167 of Act of 1912. Claimants have a right of action directly against the surety.

MASSACHUSETTS.—Ch. 197, R. S., 1902.

MARYLAND.—Art. 63, Sec. 1, P. G. L.; but no lien for materials in Baltimore City.

MINNESOTA.—R. S., 1905, Sec. 3505. G. S. 1913, Sec. 7020.

MISSOURI.—Annotated Statutes, 1906. Sec. 4203. Rev. St. 1909, Sec. 8212.

MONTANA.—Rev. Code, Sec. 7290 et. seq.

NEBRASKA.—Cobbey's Annotated Statutes, Sec. 7101.

RHODE ISLAND.—Ch. 257, Sec. 6, General Laws 1909; Hatch vs. Faucher, 15 R. I. 459. Applicable only to labor and not to materials.

SOUTH DAKOTA.—Compiled Laws 1913, p. 463-a; Laws 1913, Ch. 263.

TEXAS.—Sayles Civ. St., Sec. 3294.

WASHINGTON.—Rem. and Bal. Code, Sec. 1129.

WISCONSIN.—Wisconsin Statutes 1911, Sec. 3315.

WYOMING.—Compiled Statutes, Secs. 3799, 3816.

Third: The other main class of laws, which follows what is known as the New York rule, provides that the lien shall attach only to the unpaid balance of the contract price due by the owner to the contractor after the contract has been completed; so that if the owner pays the entire contract price to the contractor, in compliance with the contract, the claimant can recover nothing; or if the contractor defaults, and the owner is required to complete, the claimants are entitled only to the balance of the contract price, after the cost of completion is deducted. In such cases, the right to the lien does not affect the surety's liability at all, and may be ignored; for, if the owner makes his payments in strict accordance with the contract, he cannot be held liable for more than the contract price, and therefore the surety will be liable for nothing. If, on the other hand, he overpays the contractor and thereby incurs a liability for liens, he, by that very act, releases the surety from all liability. The only obligation of the surety is to pay the expense of having the liens removed from the record.[1]

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[1]The New York rule, with modifications as shown, is in force in the following States:

ALABAMA.—Sec. 4754, Code 1907; but if the person, firm or corporation, before furnishing any material, shall notify the owner in writing that certain specified material will be furnished to the contractor for use in the building, the furnisher of such material shall have a lien for the full price without regard to whether the amount of the claim exceeds the unpaid balance or not, unless the owner shall notify the furnisher in writing before the material is used that he will not be responsible for the price thereof.

COLORADO.—Secs. 4025-6, Colorado Statutes Annotated, 1911, provided the contract price is payable in installments as the work progresses and at least 15 per cent. is reserved until 35 days after completion.

CONNECTICUT.—Sec. 4138, General Statutes, 1902; Waterbury Lbr. Co., vs. Coogan, 73 Conn. 519, 48 Atl. 204.

DISTRICT OF COLUMBIA.—Sec. 1240, Code for D. C., as amended to March 4th, 1911 (Meyers).

FLORIDA.—R. S. 1906, Sec. 2211; Stringfellow vs. Coons, 57 Fla. 158, 49 So. 1019.

Sec. 116.—**Limitation of Liability by Conditions in the Bond.** In perhaps the majority of cases, surety companies are permitted to issue their own forms of contract bonds, and those forms generally impose certain limitations and restrictions upon the liability of

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ILLINOIS.—Rule substantially the same as in New Hampshire. Hurd's Rev. St., Ch. 82, Secs. 35-41. If the original contract provides that there shall be no liens upon the improved property for labor or materials, then sub-contractors and materialmen are not entitled to any lien. Kelly vs. Johnson, 251, Ill. 135.

IOWA.—This rule was undoubtedly in force until July 4th, 1913. (Code, Sec. 3093), but an act passed at that time may be construed to require of the contractor a bond conditioned to pay all bills for labor and materials. Pending a construction of this act by the courts, it should be assumed that the surety is liable for all bills left unpaid by the contractor.

KANSAS.—Statutes provide that owner is not liable for more than he agreed to pay the original contractor, but the risk of all payments made to the original contractor is upon the owner until the expiration of 60 days after completion; the owner being entitled to credit for payments made to laborers and sub-contractors during the 60 days, provided that where the cost exceeds the contract price, he is entitled to credit only to the extent of the *pro rata* amount to which the other laborers and sub-contractors would have been entitled if they had filed their liens. Gen. St., 1909, Sec. 6246; Fossett vs. Lumber Co., 76 Kan. 428). If the owner reserves the right to and does pay to laborers and sub-contractors, upon orders of the contractor, all that becomes due under the contract and refrains from paying sub-contractors more than about 75 per cent. of the value of the work done by them, he will not likely be required to pay a substantial sum in excess of the contract price. It is important, for the protection of the surety, that such a provision be put in the contract, and that the owner be obligated, by a condition in the bond, to comply with it. It is probable that when the owner pays the general contractor, and he in turn pays the laborers and sub-contractors, the owner will be entitled to credit as if he had paid them direct, but this point does not appear to have been expressly decided.

KENTUCKY.—The law is substantially the same as in Kansas, and it seems to have been decided that the owner will be entitled to credit for sums paid by the general contractor to sub-contractors, provided that if the sub-contractors can recover from the owner less than the full amount of their claims, the sum paid by the general contractor will first be applied to the portion not recoverable from the owner. Carroll's Statutes, 1909, Sec. 2463. Central Trust Co. vs. Richmond R.R. Co., 68 Fed. 90; 15 C. C. A. 273; 41 L. R. A. 458.

MICHIGAN.—Howell's Michigan Statutes, Sec. 13766 (Compiled Laws, Sec. 10710); Smalley vs. Gearing 121 Mich. 190. But owner must require contractor to furnish sworn statement of the number and names of every sub-contractor or laborer in his employ and of every person furnishing materials, giving the amount due and to become due; and the risk of all payments made before the receipt of such statement is upon the owner until the expiration of 60 days after completion; and no payment made before the expiration of 60 days shall defeat any liens unless the payments be distributed among sub-contractors, material men and laborers If the owner is expected to comply with the law, an express provision to that effect should be inserted in the bond.

MISSISSIPPI.—Code, 1906, Sec. 3059, as amended by Act 1912, Ch. 232; Herron vs. Warren, 61 Miss. 509.

NEW HAMPSHIRE.—Laborer or furnisher of material may have a lien for full amount, if he gives notice in writing to the owner or

the surety and give the surety certain rights it would not otherwise have. The bonds of the several companies, although by no means uniform, usually contain, among others, provisions to the effect (1) that in the event of default on the part of the principal, the surety shall have the right, at its option, to assume the contract and to sublet or complete it; and (2) that the surety shall not be liable for any loss or damage resulting from mob, riot, civil commotion or a public enemy, or from "strikes" or labor difficulties, or from accident, fire, lightning, tornado or earthquake.

The first provision is a valuable one because, in many cases where the owner is permitted to complete a job on which a bonded contractor has defaulted, he will interpret the specifications very liberally in his favor, and will likely expend considerably more money than

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to the person having charge of the property, before performing the labor or furnishing the material, that he will claim a lien, and gives an additional notice as often as once in 30 days of the labor performed and material furnished during the preceding 30 days. The owner is required to retain out of the sums due or to become due to the contractor, a sufficient sum to pay the claim. If the notice is given after the labor is performed or the material furnished, the lien will be valid only to the extent of the amount due or that may become due to the contractor. Public Statutes, Ch. 141, Secs. 13-15, as amended by the Act 1911, Ch. 116. It may be that the failure of the owner, after receipt of such a notice, to retain enough to pay the claim would release the surety; although if the owner is expected to retain the money, it is advisable to put an express provision to that effect in the bond.

NORTH CAROLINA.—Pell's Revisal of 1908, Sec. 2019 and notes.

NEW JERSEY.—Secs. 2 and 3 of the Mechanics' Lien Law as found in Comp. Statutes 1910, pgs. 3293-4, provided the contract, or a duplicate thereof, be filed in the office of the Clerk of the County in which the building is situate at or or before the time when the building is begun. La Foucherie vs. Knutzen, 58, N. J. L. 234, 33 Atl. 203.

OHIO.—Act passed April 16th, 1913, which is similar to the law in Michigan. If the owner is expected to comply with the law an express provision to that effect should be inserted in the bond.

OKLAHOMA.—The law is substantially the same as in Kansas and will no doubt be construed in the same way. Comp. Laws 1909, Sec. 6153.

SOUTH CAROLINA.—Code 1912, Sec. 4114.

VERMONT.—Pub. Statutes, 1906, Secs. 2644-5.

VIRGINIA.—Pollard's Code, Sec. 2477; Schreiber vs. Bank, 99 Va. 257.

WEST VIRGINIA.—Code 1906, Sec. 3114; Code 1913, Sec. 3846, provided the contract is recorded in the office of the Clerk of the County Court prior to the performance of the labor or the furnishing of the material.

the contractor would have done, and may therefore impose upon the surety company a loss it would not otherwise have sustained. It will be seen that where the liability of the owner is limited to the amount of the contract, that is to say, where the surety is liable for any excess over that sum, and where the owner is permitted to carry out the contract and interpret the specifications, he is apt to be rather liberal with himself. The surety is helpless because it is seldom, if ever, possible to show that the owner has done a better job than is specified.

The second provision is also valuable, in that it relieves the surety from the chance of loss on account of extraordinary hazards. It is proper that the surety should be so relieved, as they are not proper risks for a surety company, and the owner should protect himself by proper insurance. The premium paid to the surety company for the bond does not enable it to purchase such insurance nor to take the risk of such a loss.

In some states, it is necessary for contractors to give a statutory form of bond in which the surety is not permitted to impose any limitations upon its liability as fixed by the contract and specifications. And in some cases, the owner will not accept a bond that imposes any such limitations. In all such cases, it is particularly important to see that the contract makes proper provision for the protection of the contractor and his surety from extraordinary hazards, or that adequate protection is provided by insurance.[1] Otherwise,

[1]See Sections 113-114.

more than the usual caution in issuing the bond is necessary.

Sec. 117.—**Where Contract Antedates the Application for the Bond.** The fact that a contract bond is applied for a considerable time after the signing of the contract is a suspicious circumstance which should be carefully investigated. It may be an indication either that the contractor has made application to other companies for the bond and been rejected, or that he started the work without bond and that the owner, finding he was not making satisfactory progress, or that he was not paying his bills, decided to require a bond. The result may be that to execute the bond would be to assume liability for a defaulting contractor. In such cases it is advisable to require a full and satisfactory explanation of the delay; and, if the delay has been for as much as two weeks, to require of the owner a certificate to the effect that the contractor is not in default and that there is no more reason for requiring the bond than there was when the contract was signed. This is not a merely theoretical danger; the records of surety companies will show that they have been thrown almost immediately into severe losses by not observing this danger signal. It is difficult enough, when every precaution is taken, to discover the contractors who are attempting, by false statements or other means, to get bonds to which they are not entitled; so that it is important to consider carefully every indication of danger.

Sec. 118.—**The Underwriting of Supply Contract**

Bonds. While the great majority of contract bonds are written in connection with building contracts, yet a considerable number are required to guarantee merely the future delivery of merchandise. Such bonds are known as supply contract bonds, and the term is limited to cover contracts only for the delivery of the merchandise and not those requiring the contractor to install it or to do anything other than deliver it.

In underwriting these bonds, the general principles heretofore outlined for the underwriting of building contract bonds will in the main be applicable.[1] However, supply contracts generally require no especial skill, and payments are usually made promptly upon delivery of the merchandise so that the capital is not tied up for a long period. The risk is therefore not as hazardous as on building contract bonds, and a man may be permitted to have on hand perhaps two or three times as much work as would a building contractor with the same resources.[2] The adequacy of the price is perhaps the principal question to be determined; and, as in the case of building contracts, it is necessary to examine the other bids, if any, and to get all available information on this point.[3] So far as the adequacy of the contract price is concerned, these contracts are presented in four aspects.

In the first place, the applicant may be the owner of the merchandise which he has agreed to sell and deliver, and may be holding it for that purpose. In that

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[1]See Sections 102-112.
[2]See Section 107.
[3]See Section 110.

event, there is little chance that he will fail to comply with his contract, and the risk is not ordinarily very hazardous.

In the second place, he may be the owner of a factory which is producing merchandise like that required to be delivered. In that event, the continuance of the factory is the principal consideration; and that will depend largely upon the financial standing of the applicant and the length of time intervening before the delivery is due.

In the third place, the principal, although not actually the owner of the merchandise, may have an option to purchase it at a lesser price than that at which he has agreed to sell it, so that the sale will bring a profit. If the option contract is with a responsible party, the bond in this case would likewise not be very hazardous.

But if the principal intends to purchase the merchandise in the open market at the time delivery is due, the transaction is a speculative one and the bond should not be signed unless the principal is of such financial responsibility as to justify the expectation that he will be able to stand the loss in case the market for the commodity should rise. The probability that it will rise will of course depend upon the character of the commodity and the length of time between the awarding of the contract and the date of delivery. Where the applicant is in the habit of signing contracts for the future delivery of merchandise and taking the chance on the rise of the market, it is suggested that he ought not to be permitted to have on hand contracts in excess of ten times the amount of his net available resources,

each case however depending upon individual circumstances.

Sec. 119.—**The Underwriting of Maintenance Bonds.** Contractors are sometimes required, not only to do the work covered by their contracts, but to guarantee the wearing qualities or efficiency of the whole or a part of it. The wearing qualities of streets, roads, bridges, roofs and the like; and the efficiency of heating, filtering and other plants are among the subjects of such guarantees. Bonds covering these maintenance guarantees are, in their nature, essentially hazardous; because, in the first place, there is no means of knowing that the road, street, bridge or roof will last during the stipulated period, or that the heating or filtering plant will do what is expected of it; and, in the second place, the financial responsibility of the principal, at the time the bond is signed, is no satisfactory criterion by which to determine what it will be at the end of the maintenance period; for he may not only become insolvent, but may die and his estate be distributed to his heirs, or he may go to parts unknown, or may go out of business and dispose of his property.

Five year maintenance on street paving is the most frequent subject of maintenance guarantees; and, when such bonds are applied for, the whole proposition should be carefully considered, as such guarantees are particularly hazardous, unless conditions are exactly right, and collateral security is generally necessary. The risk that is necessarily involved in such a guarantee is great enough, but it is well known that in nearly every city

there are a number of contractors who have sufficient political influence to so blind the city inspectors that they will permit inferior workmanship and the use of inferior materials; and some cities and towns, particularly the smaller ones, in order to save expense, will sometimes specify an inferior pavement and nevertheless expect a five year guarantee.

In order to determine the conditions under which pavements may be expected, with slight repairs, to last five years, and to determine the amount that will be required to make those repairs, it is not necessary to be an expert paving engineer.[1] There are only a few points that need be considered by a surety underwriter; and for practical purposes, a layman can pass on these as well as an engineer, although of course the advice of an engineer is always advisable. There are two cardinal rules which should be observed in all cases.

1. No pavement should be guaranteed for five years unless the bed of the street is well drained. If the subgrade is soft or wet, the pavement will not stand under heavy traffic, even though there may be a good concrete foundation. Maintenance guarantees should be avoided in all cases where the particular street or any considerable portion of it is below the water level or where the subgrade is not perfectly drained.

2. No pavement should be guaranteed for five years unless it is to be laid on a concrete foundation and

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[1]In attempting to fix the conditions upon which maintenance bonds on street paving may be issued, I have relied upon the opinions of several expert paving engineers and have had the benefit of certain data obtained from a number of city engineers by the late J. B. Hull, Engineer of the American Bonding Company, for which I am indebted to Mr. W. B. Wood who was Mr. Hull's assistant and who succeeded him.

unless the concrete is to be six inches thick, on streets where the traffic is heavy and four inches where the traffic is light. The usual mixture of 1 part of cement to 3½ parts of sand and 7 parts of broken stone or gravel is satisfactory.

A dry subgrade and a good concrete foundation are two absolute essentials to a good pavement; and unless a pavement is up to the standard in these two respects, it cannot be expected to last five years. If it is up to the standard, it is then necessary to consider whether or not the surfacing is satisfactory. The requirements for the different paving materials are different, so we must consider them separately. But it is not necessary to go into details, regarding which there may be a difference of opinion among engineers; it is necessary only to consider the particulars wherein a variation from standard specifications will materially affect the wearing qualities of the pavement and will mean a noticeable reduction in the cost.

1. Granite block or stone block of standard quality and size, if laid on a foundation as above stated, will, with very slight repairs, last five years; and five cents per square yard is sufficient collateral. In this pavement, a bituminous filler is satisfactory.

2. Creosoted wood block, of standard quality, with bituminous filler, if laid on a foundation as above specified, will last five years; and five cents per square yard will generally be sufficient to make all necessary repairs.

3. A pavement of vitrified brick is one which may

or may not be satisfactory, depending upon the character of the brick and of the filler. In order to determine whether or not brick of this kind is of standard quality, it is customary to subject it to the ''rattler test;'' and if, in the test, it loses more than from 20% to 22% of its weight, it is considered defective. It has been found that brick which will not meet this test will not last; and it is a fact that hardly more than 25% of the brick manufactured will meet this test. The other is rejected by the larger cities and are sold to the smaller cities and towns where the test is not applied.

In order to make a first class pavement, it is necessary not only to use good brick, but also to use ''grout'' filler—a thin mixture of cement, sand and water. It has been found that the smaller cities, in order to save expense, sometimes use a bituminous filler, but it is not satisfactory. The following collateral requirements are suggested:

a. If the brick is to be tested and grout filler is to be used, five cents per square yard.

b. If the brick is not to be tested, ten cents per square yard.

c. If grout filler is not to be tested, ten cents per square yard.

d. If neither the brick is to be tested nor grout filler to be used, fifteen cents per square yard.

4. Sheet asphalt may be of Trinidad or Bermudez natural or Mexican or California refined asphalt. It should be laid at least 1½ inches thick on a binder 1½ inches thick. In that event, and if the foundation is as above specified, ten cents per square yard will be

sufficient collateral. If a cheap grade of asphalt is to be used or if it is to be less than 1½ inches, collateral at the rate of 25¢ per square yard is necessary, as in that event, a large portion of the pavement will have to be replaced within five years.

5. Bitulithic pavement is a patented article controlled by Warren Brothers Company of Boston; and can legally be laid only by them and their licensees. When so laid, it will generally last five years, and since the indemnity of Warren Brothers Company, which is a very strong concern, is generally given in connection with maintenance guarantees on this pavement, such guarantees are considered safe.

6. Asphaltic macadam, bituminous macadam and bituminous concrete are different names for the same thing. It is very similar to Bitulithic and is said to be an infringement of Warren Brothers' patent. However, when laid in accordance with the "Topeka Specifications" it is said not to be an infringement. This is not a very expensive pavement and is being used more and more. Some engineers predict that in a few years it will be used more than any other pavement.

The wearing qualities of this pavement cannot be determined from the specifications, because so much depends upon the manner in which it is put down and it is so easy to deceive the inspectors. Collateral at the rate of at least twenty-five cents per square yard should be required.

7. Concrete pavements, whether laid in a solid sheet or in blocks, have not proven satisfactory, and they should not be guaranteed without full collateral.

This kind of pavement is very brittle and on account of the expansion and contraction, is apt to crack and go to pieces in a comparatively short time.

It is hardly necessary to add that macadam pavements, whether they are to be covered with oil or tar or not, should not be guaranteed without full collateral.

Collateral as above specified has been found reasonably sufficient to make the repairs that will be necessary in the different pavements during five years; and it is not within the scope of this book to say when, if ever, these collateral requirements may be waived. However they should in no event be waived except on stone, granite, wood block, and vitrified brick, and on sheet asphalt when the asphalt is to be at least two inches thick; and they should not be waived unless the pavement is to be of the highest standard above specified, nor should they be waived unless the applicant is very strong financially, has been in business for a number of years, bears a good reputation and is not suspected of receiving "favors" from the city inspectors in the shape of permission to lay an inferior pavement; and unless the indemnity of two or three persons worth two or three times the value of the work to be guaranteed is received. In the case of stone, granite or wood block or vitrified brick, the company furnishing this material should be required to agree to replace any that may be found during the maintenance period to be defective.

It is not practicable to go into the matter of maintenance guarantees in greater detail, but as a general proposition it may be said that, on account of the prob-

ability that the principal will die, move away, or become insolvent, there are few cases where a surety company would be justified, without collateral, in executing a maintenance guarantee for as much as five years, although a guarantee of one year, or even two years, may often be made. All such guarantees should be passed upon by the company's engineer.

Efficiency guarantees are, in a sense, more hazardous than maintenance guarantees, because, if the thing guaranteed does not come up to the requirements, it is generally necessary to replace it, so that the whole penalty of the bond will likely be consumed. Generally, however, the liability will accrue within a short time after the bond is executed, so that the financial standing of the applicant is not likely to change in the mean time. In this connection, it may be well to call attention to the fact that there may be a delay in testing heating plants, unless proper provision is made. The specifications for these plants generally call for a certain temperature in zero weather, or so many degrees below zero; and if that temperature is not reached the first winter, it may be contended, after the lapse of several years, when the principal has gone out of business, that the plant does come up to the requirements. It is therefore advisable to limit the guarantee to one year. This is not a hardship on the obligee, as it can be determined, on the basis of percentages, whether, as a fact, the plant will heat the building in colder weather.

CHAPTER VI.

DEPOSITORY BONDS.

Sec. 120.—**Scope.** In many cases where money is deposited in a bank, the owner requires the bank to give bond, with surety, conditioned for the safe-keeping of the money and for its prompt return on due and legal demand. Such bonds are known as depository bonds and are very frequently issued by surety companies. The purpose of this bond is to protect the depositor from loss in case the bank should fail, that being the only way in which a proper demand for the money is likely to be refused; and the condition of the bond is broken and liability accrues as soon as the bank closes its doors.

The great majority of these bonds are required for the protection of public money. In some cases, the depositories are provided for by law, and are designated by the constituted authority in the State, county or city, as the case may be, and are required by law to give bond. In other cases, officers having the custody of public money, and being responsible for its safe keeping, voluntarily require the banks in which they keep the money to give bond. These bonds are often made so as to protect both the officer and his surety, as their interests may appear. In some few cases however, particularly in times of financial stringency, private individuals, firms and corporations require the banks in which they keep their money to give depository bonds. In all such cases, the bank is named as principal, and

the bond is limited to cover the funds of a particular person, corporation or body politic.

Sec. 121.—**The Underwriting of Depository Bonds.** As we have seen, the condition of a depository bond is broken and liability of the surety accrues as soon as the bank closes its doors and declines to pay depositors. The chance of loss under such a bond depends upon the continued solvency of the bank; and the extent of the loss may be affected by the character of the particular contract or obligation, in so far as it may affect the extent of the surety's right to participate in the distribution of the bank's assets. The character or "personality" of a bank is made up of its financial condition and the character of its management; and these matters will first be considered. We will then take up the matter of the extent of the surety's right, under different conditions, to participate in the distribution of the assets.

Sec. 122.—**Financial Condition.** The financial condition of a bank will depend upon what is shown by its own statement and the probability that that statement represents its true condition. A financial statement of a bank is simply a summary of the contents of its books and shows a balanced account made up of "liabilities" on the one side and "assets" on the other. The liabilities are made up of capital, surplus, deposits, borrowed money, and the like; and the assets consist of the corresponding amount of cash, or its equivalent, in the shape of investments or deposits in other banks.

In analyzing a bank's statement with a view of determining its strength, the two things to be consid-

ered are (1) whether the liabilities are in the proper relative amounts, and (2) whether the assets are properly invested and are worth the amount for which they are carried. The relation between the several items of liabilities will first be considered.

Sec. 123.—**Liability—Capital and Surplus.** When a bank becomes insolvent and closes its doors, all its assets, including the money paid in as capital, will be used to pay the depositors; and, to that extent, the capital is a margin of safety. But a surety for a bank is concerned primarily with the question of whether the bank will continue in business so as to meet the demands of its depositors; and, inasmuch as a bank cannot continue in business without a surplus fund, it is apparent that that is the real margin of safety; the chance of insolvency being in inverse proportion to the size of the surplus.

The capital and surplus are not, however, to be considered in the absolute, but only in their relation to the other liabilities. $25,000.00 will be an ample surplus for a bank with $50,000.00 of capital and $250,000.00 of deposits, but will be wholly insufficient for a bank with half a million of capital and two million of deposits. In the handling and investment of large sums of money by a bank, there are, of necessity, many chances of loss or depreciation of assets—the chance being in direct proportion to the amount to be cared for and invested; and unless the surplus is large enough to take care of a reasonable loss or depreciation, the bank is not a good risk. This is another way of saying

that while a large line of deposits may be an evidence of the confidence of the public, and therefore a good sign,[1] yet, if there is not a proportionate surplus, the increased deposits may really weaken the bank.

It is not practicable to lay down a hard and fast rule as to the amount of capital and surplus a bank ought to have to be reckoned as safe, because other things are to be considered.[2] They should, as we have seen, be figured on the basis of the amount of the deposits or on the total amount of the liabilities; and it is suggested that it is reasonable to require a bank to have a combined capital and surplus equal to twelve or fifteen per cent. of its deposits, and a surplus alone equal to four or five per cent. There may be cases where, by reason of compensating advantages in other directions, a smaller capital and surplus would be satisfactory. The amounts herein mentioned are intended to be merely suggestions for the average case. But we must bear in mind that, while an adequate surplus is essential, it is not the sole, or even the most important, consideration in the question of the safety of a bank. As we shall see, a bank may be in a weak, or even critical, condition and still have a large nominal surplus; and furthermore, it is not difficult, by a comparatively slight inflation of the assets, to show a fictitious surplus.[3] Therefore while an adequate surplus is necessary, yet a risk should not be accepted merely *because* the bank has a large surplus.

1See Section 124.
2See Sections 126-129.
3See Section 126.

Sec. 124.—**Deposits.** We have just seen that the surplus of a bank ought to be increased in proportion as the deposits increase, and that it ought always to bear a certain relation to the deposits. It is not to be inferred however that a large line of deposits is an undesirable thing. On the contrary, it is most desirable as it is an element of great strength. The deposits of a bank are the source of its earnings; earnings or earning power means prosperity, and the prosperous banks rarely, if ever, fail.

It has been found in practice that by far the largest percentage of failures is among the small banks, that is, banks with small deposits, and that the percentage of salvage received from them is smaller than from the larger banks. Indeed the experience of the companies seems to indicate that, up to a certain point, the risk on a depository bond is in inverse proportion to the amount of the deposits. As a rule, a bank with deposits of less than $60,000 should not be accepted at all, as such a bank necessarily has a small margin of safety and furthermore is not likely to make enough to pay its legitimate expenses, such as rent, salaries, heat, light, etc., and may therefore be compelled to employ inferior men, occupy poor quarters and go backward instead of forward.

A large line of deposits is not only a source of large earnings, but it is an evidence that the bank has the confidence of business men, which is always a good sign, as they may be assumed to be familiar with the character of the management. In this connection it is important to note the effect of an increasing or of a

decreasing line of deposits. A decrease of deposits is an evidence of the loss of the confidence of the public, which is so essential to the success of a bank, making the possibility of a "run" the more imminent; and, it is likely to weaken the bank and lessen its ability to meet the demands of its depositors in the future. This is so, because in order for the bank to meet the withdrawals, it must have been necessary for it to use its best or most "liquid" assets, that is, the assets that were of unquestioned value and on which cash could be most easily realized. This necessarily increases the proportion of "slow" or poor assets remaining in the hands of the bank, and puts the bank in an abnormal condition, where its ability to get money to meet the further demands of its depositors is greatly weakened. Even a slight "run" would probably compel such a bank to close its doors. It is suggested therefore that where a bank's deposits have been decreasing, great caution must be exercised; and where the decrease has been substantial or continuous the business should always be declined. And on the same principle, a bank whose deposits are continually increasing is a good risk. Indeed, as we have seen, a bank whose prosperity is evidenced by a large and increasing line of deposits is likely to be in a flourishing condition and perfectly safe for depositors.

Sec. 125.—**Borrowed Money.** It is considered entirely proper for a bank, at certain seasons of the year, when its customers are in need of large amounts of money for crop-moving or other legitimate purposes, to borrow a reasonable amount of money in order to meet their

needs. But it is not considered legitimate banking to make a regular practice of doing business on borrowed capital, making a profit out of the difference between the rate at which the money can be loaned and that at which it can be borrowed. The money is usually borrowed on short time, and is often loaned on longer time; and there is always a possibility that, by reason of changed financial conditions, or for other reasons, the bank from which the money was borrowed may decline to renew the loan. It may be impossible to get the money elsewhere; and the borrowing bank, having loaned out the money, may not be able to get it back in time to repay the loan, and may thereby be forced to close its doors. It puts a bank at the mercy of the bank or banks from which the money is borrowed, and is a very dangerous practice.

The national banking act permits a national bank to borrow an amount equal to its capital; and, as a rule, no bank, whatever may be the law in the particular state, ought to borrow more than that. And a bank with a small surplus, as compared with capital, ought not to borrow that much; although, on the other hand, it would probably be safe for a bank with a large surplus in proportion to capital to borrow more. Perhaps a better general rule would be to say that a bank ought not to borrow more than one-half its combined capital and surplus.

However, the *amount* of borrowed money, at any particular time, is not necessarily the true test. It is equally as important to determine that the money is borrowed for the purpose of meeting a temporary de-

mand of customers and that it is not a continuing practice. Banks should not be under "bills payable," as borrowed money is generally designated, for longer than from four to six months of the year. It is therefore not enough to examine a single statement of a bank, but its statements for at least a year should be examined so as to determine its practice with respect to borrowing money. It is suggested that a bank which has bills payable and rediscounts for more than an amount equal to one-half the combined capital and surplus, or which is in the habit of being under "bills payable" for longer than four or five months of the year, is an undesirable risk.

In this connection, attention is called to a method which some banks have of attempting to conceal the amount they have borrowed by carrying it as "certificates of deposit." When they borrow money, instead of giving a note, as is the regular practice, they give a certificate of deposit, payable at the date of the maturity of the loan. If, therefore, a statement shows a large amount of "certificates of deposit," it may be assumed, unless the contrary is shown, that this represents borrowed money. In the sworn statements, which banks in most of the states are required to make to the state banking department, it is generally necessary to state what, if any, "certificates of deposit" are for borrowed money; and if such statements are available, definite information can generally be obtained.

Sec. 126.—**The Assets.** Having ascertained that the several liabilities are in the proper relative proportions, it is next in order to determine as far as possible,

whether or not the assets are properly invested and worth the amount for which they are carried. It is well known that worthless paper is often carried as a good asset and that the assets are otherwise inflated; and just to the extent that the assets are inflated, the surplus, as shown by the statement, will be false. In other words, every dollar of false or fictitious value in the statement of assets will be reflected in the surplus.[1] Where the surplus is small or near the danger line, it is important to note the item of "furniture and fixtures," as this item is frequently inflated in order to create a surplus. In such cases, this item should be ignored and the surplus reduced accordingly.

It is not practicable for a surety company to make a special examination of the affairs of the banks that apply for depository bonds, so there is no way to absolutely determine whether the assets are what they seem. About the only light that can be thrown on this subject is by an examination of the report of the last audit of the state or national bank examiner, and by a consideration of the reputation and standing of the officers in so far as it may affect the probability that they would knowingly inflate the statement of the assets.[2] Having regard to the proper investment of the assets there are one or two points which will be considered in some detail in the following sections.

Sec. 127.—**Convertibility of Assets into Cash.** It is not enough that the assets of a bank be safely invested. They must be so invested that they can be con-

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[1]See Section 123.
[2]See Section 129.

verted into cash in time to meet any probable demand of the depositors. The ever-present danger of unusual withdrawals should always be provided for. Many banks, otherwise perfectly good, have been compelled to close their doors because their assets were not such as could readily be converted into money. Real estate and mortgage loans are recognized as "slow" assets, that is to say, assets which cannot easily be converted into money. Savings banks generally have the right, in emergencies, to require their depositors to give 30 or 60 days notice of their intention to withdraw their deposits, so that it is not so necessary for such banks to have all their assets in a form to be immediately convertible into cash; and it is generally deemed prudent for such banks to keep as much as 50% of their deposits invested in real estate and mortgage loans. On the other hand, commercial banks are likely to be called on at any time by their depositors, and they must pay immediately or close their doors. Hence the importance of having a large percentage of "quick" assets. It is not generally considered prudent for such banks to invest more than 20% of their deposits in real estate and mortgage loans combined; and where a larger percentage is so invested, the risk should be declined.

Sec. 128.—**Cash Reserve.** Just as a bank is not safe unless it has a fair portion of its deposits invested in "quick" assets, so is it not safe unless it has a fair amount of available cash. As we have seen, a bank must always be in a position to meet the probable demands of its depositors; and for that purpose, cash on hand or in other banks is necessary. National banks are re-

quired by law to carry 25% of their deposits in cash as a reserve although they are permitted to deposit a part of this in "reserve banks" or "central reserve bank" in the larger cities. Many of the states also require the banks incorporated by them to carry a cash reserve, but other states do not. However, experience has shown that it is not safe for a bank to carry a smaller reserve than 15% of its deposits; and a bank which habitually or even occasionally, permits its reserve to get below that amount, is not a good risk.

Sec. 129.—**Character of the Management.** Although the liabilities of a bank may seem to be in the proper relative proportion, and although the assets may seem to be properly invested, and worth the amount for which they are carried, yet the management of the bank may be such as to make it an undesirable risk. There are some banks which are ultra-conservative, making only high grade investments and loans only on gilt edge security, and making no loans to officers or employees, and none in excess of the limit prescribed by law. Such banks are, of course, the best risks. Other banks are managed by speculators, who, in order to build up the business of the bank, grant unwarranted accommodations to depositors, such as paying excessive rates of interest and making loans on doubtful security. Such banks often succeed in getting a large amount of deposits, but if these deposits have been "bought" with undue accommodations, the bank is likely eventually to come to grief. Still other banks are managed by dishonest men who are in the habit of making loans to themselves, or to firms or corporations in which they

are largely interested, without requiring adequate collateral; and to the extent that the collateral is inadequate, the surplus of the bank is fictitious.

As we have seen, it is not practicable to make an examination of the affairs of banks which apply for depository bonds for the purpose of determining the character of their loans and investments. However, the character of a bank in this respect is generally known, to a greater or less extent, in the community in which it operates; and it is not only important but also the duty of an agent of a surety company to make himself conversant with the local conditions in banking and business circles in order that he may act intelligently on applications for these bonds. I do not believe enough attention is paid to the investigation of the management of banks applying for depository bonds. This is very important; for, as we have seen, it is not difficult for a bank, by inflating its assets, to show sufficient surplus when it is practically insolvent. Indeed, nearly every bank that fails has an adequate nominal surplus. If the management of the bank is not such as to warrant the belief that its financial statement is dependable, the application should be declined.

Sec. 130.—**The Character of the Contract. In general.** Having determined that the particular bank is in a sound condition and reasonably safe for ordinary depositors, it is next in order to consider how the liability of the surety will be affected by the particular obligation for which application has been made; and whether or not, under the circumstances, the surety is justified in taking the risk. The liability of the surety, as it

may be affected by different conditions, will now be considered.

Sec. 131.—**Liability—As Affected by Right to Salvage.** In practice, insolvent banks always have some money to distribute to their depositors; and a surety, who pays one of the depositors, is generally entitled to receive that depositors distributive share. The amount of the surety's ultimate liability may therefore be materially affected by the extent of its right to share in this distribution. This matter is presented in three aspects.

In the first place, the particular depositor, who is the obligee in the bond, may be a preferred creditor, and entitled to receive the entire amount of his deposit before anything is paid to ordinary depositors. In some of the states, such is the law with respect to deposits of the funds of the state itself; and in a few of the states, the same rule applies to funds of counties and cities. Where such is the law, it is fairly safe to assume that a surety on a bond covering such a deposit, being entitled, upon payment, to all the obligee's rights against the bank, will not sustain an ultimate loss; because practically all insolvent banks have enough to pay preferred depositors in full. It is, however, not necessarily good policy to issue these bonds indiscriminately, because, in the first place, the failure of the bank will, if the surety lives up to his obligation, mean an outlay, for several months perhaps, of the amount of the deposit; and, in the second place, it generally means the incurring of some expense. However, a comparatively small volume of such business will take care of the in-

terest and expense; and, where the right to a preference is undoubted, a surety company can afford to be fairly liberal.

In the second place, there is the case where the obligee in the bond is an ordinary depositor and entitled to share with other depositors in the distribution of the bank's assets. In that event, the surety will ordinarily receive the full dividend rate on the amount paid by him.

But, in the third place, we have the case where the deposit exceeds the amount of the bond, or exceeds the amount of all valid and enforcible bonds covering it, and where the depositor, notwithstanding payment by the surety of the full amount of the bond, has a right to have the balance of his deposit fully repaid out of the bank's assets before the surety is entitled to anything. In cases of private contract, a surety company usually makes it a condition of its obligation that it shall be entitled to the dividends on the amount paid by it, whether the obligee shall have been fully reimbursed or not. But in cases where the bond is provided for by law, and where the condition of the bond is fixed by the statute, such a provision would probably be declared void by the courts and is not generally inserted. In such cases the surety is subjected to an extraordinary hazard in that he may be deprived of all or a part of the dividends to which he would ordinarily be entitled. The ultimate loss, in case the bank fails, is increased just in proportion as the amount of the deposit exceeds the amount of the bond, or exceeds the total amount of all valid and enforcible bonds and securities covering the

deposit. It is therefore the duty of a surety underwriter to see, in such cases, that bonds and securities, equal to the largest amount likely to be on deposit at any one time are carried; and if they are not to be carried, the bond should be written only for large banks which are in absolutely first-class condition.

Sec. 132.—**Liability—As Affected by the Right to Cancel the Bond.** In some of the cases where depository bonds are required by law, the statute makes provision by which the surety may terminate its liability by giving notice to the person authorized to withdraw the deposit.[1] And in cases of private contract, where the bond is not given in pursuance of any statute, the bond itself usually contains a provision by which the surety may terminate the liability by giving notice to the obligee. It is not generally believed that the surety on a depository bond may terminate the liability in the absence of any law authorizing it, or in the absence of any valid provision in the bond, although there seems to be a contrary opinion.[2] However, in the absence of a definite settlement of this question by the courts, it is

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[1]GEORGIA.—Governor has authority, in his discretion, upon petition of the surety, to release surety for State depositories. Code, Sec. 1255.

MISSOURI.—The court authorized to approve the bond of any depository may, in its discretion, release the surety upon its petition. Rev. Stat., 1909, Secs. 11281-88.

OHIO.—Bond of County depositories may be cancelled upon ten days' written notice to the County Commissioners, the County Auditor and County Treasurer, provided the money on deposit is withdrawn or a new bond furnished. Page and Adams Code, Sec. 2724.

VIRGINIA.—Bond of depository for the State funds may be cancelled upon petition to the Governor and upon reasonable notice to the depository. Pollard's Code of 1904, Secs. 2888-89.

WISCONSIN.—Board of deposit is authorized to cancel the bond of any State depository, but no method is provided by which the surety may start the proceedings. Wisconsin Statutes, 1911, Sec. 160-b.

[2]In this connection see an article by the author of this book in the American Law Review for November—December, 1908.

suggested that it is not safe to assume that the right does exist.

The right to cancel the bond by notice to the obligee is a most valuable right and materially reduces the real hazard involved; for, in many cases, a vigilant agent of a surety company will learn of the weakened condition of a bank, on which his company is carrying a depository liability, and of its probable failure, in time to cancel before the crash comes. And in time of financial stringency, which seem periodically to occur in this country, banks which would ordinarily be good, are sometimes unable to get money to meet the demands of their depositors and are compelled to close their doors. These bonds can be issued with much more liberality where it is known that, if a financial crisis does come, or if the guaranteed banks do grow weak, the bonds may be cancelled. Bonds which will continue in force for more than one year and which cannot be terminated at the will of the surety should be issued only for the comparatively few large banks which are in absolutely first-class condition and about which there is no question.

Sec. 133.—**The Amount of Liability**. Having ascertained that the bank in question is a reasonably safe institution and an acceptable risk, and that there is nothing in the particular obligation to make it unacceptable, it is next in order to determine the *maximum amount* of liability to be taken, for there must be a limit somewhere. We have seen that where a bank has deposits of less than $60,000, it is an undesirable risk. But if the deposits are in excess of $60,000, a liability

in proportion to the size and strength of the bank may be taken.

In determining the amount of liability that may be taken, it is necessary first to establish a basis upon which the amount is to be calculated. Some underwriters take the aggregate capital and surplus as the basis and fix 25% as the maximum amount of liability to be taken. As we have seen however, the amount of the deposits is a very important factor in determining the probability that a bank will continue in business. Therefore other underwriters take the total of the capital, surplus and deposits as the basis, and fix 5% as the maximum liability.

It is impossible to formulate a rule that will do for all surety companies, because large companies can afford to take a greater liability than small companies. But it is suggested that for a company with an underwriting capacity of $250,000 or over, it would be reasonably safe to take a total liability equal to 25% of the capital and surplus, or 5% of the capital, surplus and deposits. Whether the one or the other basis is used, smaller companies should, of course, take a smaller percentage in proportion to their size. And it is to be borne in mind that this percentage will be increased or decreased as the bank may seem in other respects to be strong or weak; and, in each case, all the possible elements of weakness and strength, as above outlined, should be taken into consideration in determining the amount of liability, as well as in determining whether or not the risk should be taken at all.

CHAPTER VII.

INDEMNITY ON LOST INSTRUMENTS.

Sec. 134.—**Scope.** It sometimes happens that when a bond, note, certificate of deposit, certificate of stock, insurance policy or other similar obligation for the payment of money, becomes due, the person to whom it was issued claims that it has been lost, stolen or destroyed, and therefore that he cannot produce it. If the maker of the instrument should under the circumstances pay it, he would run a two-fold risk. In the first place, the instrument may not really have been lost, stolen or destroyed, as alleged, but may have been sold or assigned to a third person. In the second place, if it has been lost or stolen, and not actually destroyed, it may get into the hands of a person who will be entitled to it as against the true owner, who lost it. Accordingly, the maker of the instrument, as a condition precedent to paying it, or issuing a duplicate, may require that a bond be given to indemnify him against loss in consequence of so doing. Surety companies are frequently asked to issue such bonds; and they form one of the more important of the minor classes of surety bonds.

Sec. 135.—**Liability.** The maker of the instrument generally requires such a bond as will obligate the principal and surety not only to reimburse him in event he is required to pay the obligation a second time, but also to pay all incidental costs, expenses and counsel fees. Indeed, in many cases, the principal purpose of the bond is to guard against possible expense. And in

view of the well known fact that people do make claims and bring suits that have no merit in law, it is apparent that a loss may be sustained, notwithstanding the instrument may be of such a nature that, under the circumstances, a third person could have no legal title to it as against the principal.

Sec. 136.—**The Risk. In general.** The desirability of such a risk is of course largely affected by the financial strength of the principal; for it is true in this case, as in all other cases of suretyship, that the principal stands between the surety and loss. But the object of this work is to point out the risk peculiar to the different bonds; it being the prerogative of each underwriter to say how much financial strength an applicant ought to have to justify a surety company in taking that risk.[1] The risk under these bonds will therefore be considered from the standpoint of the personality of the applicant, in so far as it may affect the question of his veracity; and the nature and condition of the lost instrument, in so far as it may affect the probability that it will find its way into the hands of a person who will be entitled to recover on it, notwithstanding the issuance of the duplicate, or the payment of the money, to the principal.

Sec. 137.—**Risk—as Affected by the Personality of the Applicant.** As will be more fully explained in the succeeding paragraphs, a surety underwriter, in passing on an application for a bond of this kind, ought to know, first, that the instrument has in fact been lost,

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[1] See however Sections 76 and 151.

stolen or destroyed, and not assigned or transferred to a third person; and, second, he ought to know the nature and character of the instrument and the circumstances under which it disappeared. In many cases, the only way of getting any information as to these material facts is through the applicant. His affidavit ought to be required in all cases; and it is important to make such an investigation of his character and standing as will be sufficient to show that reliance can be placed on his word. It is hardly necessary to add that the statements of the applicant ought to be verified as far as may be possible.

Sec. 138.—**Risk—As Affected by the Probable Destruction of the Instrument.** If the instrument has in fact been destroyed, as for example, by fire, and not merely lost, mislaid or stolen; and if, at the time of its destruction, it belonged to the applicant, there is of course practically no risk on the bond. While it is hardly possible to become absolutely sure of the destruction of the instrument and the title of the applicant, yet if the applicant is a person of good standing and reputation, and makes affidavit to facts which show, to a practical certainty, the destruction of the instrument, and further makes oath that he was the owner of the instrument and that he had not endorsed, transferred or assigned it, it is perhaps reasonably safe to assume that what he says is true. However each case will have to be governed by its own particular circumstances, for it cannot be said in advance what evidence of ownership and destruction ought to be accepted. The point to be emphasized is the distinction between a case where the

evidence shows to a practical certainty that the original instrument is not in existence, and a case where the instrument is merely lost, mislaid or stolen, and may be in the hands of one who can recover on it or who may have reasonable grounds to believe and contend that he can recover. In the first case, the bond may be executed almost regardless of the financial standing of the principal, so long as his moral standing is good enough to justify a belief that his statements and affidavit are true. In the second case, it ought to be assumed that the instrument is in the hands of a third person; and the desirability of the risk should be tested by the question whether or not such third person could probably recover on it. This question will next be considered.

Sec. 139.—**Risk—As Affected by the Character of the Instrument.** The question whether or not the holder of an instrument that has been lost or stolen can recover on it is a difficult legal question which is beyond the scope of this work; but it is possible to point out certain principles which have an important bearing on the risk of the surety.

In the first place, it may be said to be a general rule of law that in order for one to become a "*bona fide* holder for value" of a lost instrument (or a "holder in due course," as he is sometimes called) so as to entitle him to recover as against the true owner, he must, among other things, have purchased the instrument *before maturity.* If therefore, the particular instrument was lost after maturity, or if, though lost before maturity, a considerable time has elapsed since maturity and no demand has been made, it may be fair to assume that

no demand will be made, or if made, that it will not prevail.

In the second place, in order for the holder to be considered a "holder in due course," he must not only have paid value for the instrument, but he must have received it in good faith, without knowledge, express or implied, that it was lost or stolen. It is needless to say therefore that the finder or thief could not recover as against the true owner; nor could one who was actually or impliedly in collusion with the finder or thief recover. The instrument must have been transferred to an innocent third person for value. The risk therefore will be affected largely by the ease or difficulty with which the instrument could probably be thus transferred.

In considering this question, it will be convenient to divide the instruments into three classes. First we have those instruments which are transferable by mere delivery without any endorsement, such as mortgage bonds and notes, certificates of deposit, etc., payable to bearer; or instruments which, though payable to the order of a particular person, have been endorsed by him in blank. If such an instrument were offered for sale, the suspicions of a prospective purchaser would ordinarily not be aroused and a sale could probably be made. This is the most dangerous class; and, unless such an instrument has undoubtedly been destroyed, or has long since matured, it is not a legitimate surety risk.

In the second class, we have those instruments which, though transferable by endorsement, have not been endorsed by the payee; and where, in order to negotiate

them, the signature of the payee would have to be forged. Under the uniform "negotiable instruments law" which is in force in many of the states, a forged signature is wholly inoperative to pass title to a negotiable instrument, and no right to enforce payment against any party thereto can be acquired through or under such signature. If that is the law in the particular state with respect to the particular instrument, and that instrument has not been endorsed by the true owner, then it is practically certain that no third person can acquire a title that will be good as against the true owner.

The third case is that where the instrument is not, strictly speaking, a "negotiable instrument," in the sense that it may be transferred by endorsement or mere delivery, but where an assignment is necessary; as for example, an insurance policy. It is hardly possible, under any circumstances, to pass title to such an instrument by a forged assignment; and if the instrument has not been assigned, there is practically no chance that a claim could successfully be made by a third person. The contingency that insurance companies really intend to guard against is the possibility that the insured may in fact have assigned the policy. Reference has already been made to the importance of ascertaining the genuineness of the loss.

Sec. 140.—**Summary.** The substance of this chapter may be summarized as follows: (1) Where the instrument actually has been destroyed, and was, at the time of its destruction, the property of the applicant, there is little, if any, danger of loss. (2) Where the instrument is transferable by more delivery, and is not

known to have been destroyed, the risk is hazardous, until a considerable time has elapsed after maturity. (3) Where the instrument is transferable only by endorsement, and has not been endorsed, there is generally not much danger, particularly if the instrument has matured. But where the "negotiable instrument law" is not effective, the law as to the effect of a forged signature may be different. (4) Where the instrument is not negotiable, but is transferable only by assignment and has not been assigned, there is little chance of loss in any state.

The foregoing propositions depend upon the accuracy of information which can often be obtained only from the applicant; hence the importance of investigating his character and standing.

CHAPTER VIII.

BOND ON ASSIGNMENT OF ACCOUNTS RECEIVABLE.

Sec. 141.—**Scope.** It sometimes happens that a merchant, who does a large business, feels that if he had the use of the money that is due him, he could use it to advantage in his business and make a good profit. He therefore decides to sell the outstanding accounts or borrow money on them. Feeling, however, that it would be disastrous to permit the purchaser to collect the accounts, thus making his customers aware of the fact that he had sold them, he sometimes resorts to the expedient of selling the accounts, or borrowing money on them, with the understanding that he will be permitted to collect them and account to the purchaser for the proceeds; and there are concerns whose regular business is to purchase accounts receivable, or lend money on them, subject to that condition. The purchaser runs a threefold risk, namely, that invalid or fictitious accounts will be assigned, that the assigned accounts will not be collected, and that, if collected, the proceeds will not be turned over to him. And, as a rule, prospective purchasers demand security against loss in these particulars, and surety companies are often asked to give that security.

It is apparent however that it is not within the scope of a properly conducted surety business to guarantee that the money due on the accounts will be collected; for that would be credit insurance of the worst character. Nor would it be proper to guarantee that no invalid

accounts would be assigned, for that would guarantee the validity of contracts about which the surety would have no information. But under certain conditions, a bond may be written guaranteeing that no *wholly fictitious* accounts will be *intentionally* sold and assigned, and that the assignor will not misappropriate any money that may be actually collected. Those are, in the main, guarantees of honesty; and such guarantees are within the scope of the surety business, although it would seem to be better to limit the guarantee to misappropriations of money actually collected. In any event, the risk, as we shall see, is extra-hazardous, and is to be assumed only in cases of carefully selected concerns and where the risk can be surrounded with the proper safeguards. One company, which formerly made a specialty of this business, has entirely abandoned it as unprofitable, but it is believed that by carefully selecting the risks, sounding them with the most approved safeguard, and charging a rate of 2% or more, the business would be profitable.

Sec. 142.—**Opportunity.** It is usually one of the conditions of the contract of assignment that the assignee shall not make it known to the debtors that the accounts have been assigned, and therefore, it is not possible for the assignee to verify the outstanding assigned accounts by sending statements or bills to the debtors. But, if no verification is to be made, it will not be difficult for the assignor to assign fictitious accounts and to omit to pay over money collected and account for his failure to do so by saying the money has not been collected. There are few, if any, cases where a surety company would be

justified in taking a fidelity risk where the opportunities were so absolutely unlimited and where no satisfactory audit or check could be made.[1] In order to make these bonds, as a class, worthy of consideration, it has been found necessary that some arrangement be made by which the assignee can make a satisfactory audit of the outstanding accounts. The method followed by an audit company, when making an audit of a bank, suggests a method applicable to this case. The audit company sends to each depositor a notice of the amount to his credit as shown by the books of the bank and asks if that amount is correct. So it would seem to be feasible, in most cases, to have an audit company or a professional auditor, for a nominal fee, periodically, say once in three months, to send statements or bills to the debtors of all outstanding assigned accounts. The replies to such statements would probably show what accounts, if any, were fictitious and what, if any, had been paid. The sending of such statements would ordinarily not excite any suspicion; and it is suggested that a condition to that effect be put in all bonds of this class. Other methods just as good or better may perhaps be suggested, but the point is that unless a way be provided by which the genuineness of the assigned accounts, and the alleged non-payment of accounts that are due, can be verified, the business is ordinarily not desirable.

The opportunity may, in a measure, be limited by arranging to have an employee of the assignor, such as the cashier or bookkeeper, who has no financial in-

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[1]See Section 12.

terest in the business, designated as agent of the assignor, to make the assignments and collect the accounts; and by having him alone made the principal in the bond. In cases where the assignor is a firm or corporation, it is specially important that this be done, because (1) a surety company cannot afford, in one bond and for one premium, to take a fidelity risk on more than one person; and (2) any conversion would likely be made to the use of the firm or corporation; and it is doubtful if that would constitute a punishable offense by any individual.[2] And even where the assignor is an individual, it would be safer to make an employee the principal. The employee will not be subject to the same temptation as the employer, although he will be more or less under the employer's influence; and furthermore, the necessity for his signature will require collusion between at least two persons to commit a breach of the bond. When such an arrangement is made, the indemnity of the real parties in interest,—the members of the firm or the officers of the corporation[3]—ought to be required.

Sec. 143.—**Temptation.** If these bonds are issued only on behalf of those who can, after paying interest and expenses, use the money profitably to increase their business, the temptation will not be extraordinary. But it is especially necessary to avoid the man who has a large volume of accounts payable, who is being pressed by his creditors, and who is trying to borrow in order to avoid bankruptcy; for in that event the temptation

[2] See Section 16.
[3] See Section 199.

may be very great. In the ordinary fidelity bond, we deal with a man who is making his living from his salary, where his earnings are deemed sufficient for his needs and where there is theoretically no extraordinary temptation to convert the employer's money. If we bond a man who is in financial straits, we shall be dealing with a merchant, who has no credit at the banks, and who, in order to meet his bills, is compelled to sell his accounts receivable at a liberal discount or borrow on them at a high rate of interest. And the discount or the interest, being, in many cases, sufficient to consume a large portion or all of the net profit on the goods sold, it will be only a matter of time when the advances he can get on his accounts will not be sufficient to meet his bills, and he will be compelled to sell fictitious accounts, or use some of the money he has collected on accounts which he has assigned, or be forced into bankruptcy. It is hard for a man to reliquish a business, which may be his only means of livelihood and which perhaps he has built up after years of effort; and the temptation to use the assignee's money in anticipation of better things, is hard to resist, especially if there is a chance that its use can be concealed for a reasonable length of time. The applicant's books should therefore be examined for the purpose of determining whether or not his bills and accounts payable are unusually large and whether or not any of them are overdue. If there is any evidence that he is being pressed by his creditors or that he is getting the money to meet his bills and not to increase his business, the bond should be declined.

Another subtle temptation may creep into a case of this kind as a result of the payment of the accounts, by the respective debtors, before they are due. If an account should be paid to the assignor before it is due, he will most likely consider that he is entitled to use the money until the maturity of the account, and will therefore put it into the business, intending, perhaps, to pay it over to the assignee at the proper time. When the account does mature, he may not be able to pay back the money, and may thus get behind and eventually be forced into bankruptcy.

Sec. 144.—**The personality of the Risk.** In considering the moral risk in a particular case, it is of course necessary to investigate, not only the record of the applicant who is to be the principal in the bond, but of all parties interested, that is, the members of the firm or the officers of the corporation, as the case may be; for they will no doubt be the moving cause of any breach of the bond, notwithstanding the act may be done by the applicant. And such bonds should be issued only for concerns whose reputation for honesty and integrity is firmly established; and the record of the principal should be investigated, not only to ascertain his probable honesty, but also the probability that he will act independently of the assignor in matters relating to his obligations under the bond.

Sec. 145.—**Summary.** Reviewing the contents of this chapter, we find:

(1) That the bond should be limited to cover only the misappropriation of money or property actually collected on the assigned accounts; although it may be

reasonable, in some cases, to guarantee that no *wholly fictitious* accounts will be *knowingly* assigned.

(2) That the opportunity and temptation are so great as to render the risk extra-hazardous.

(3) But where the bond is so restricted as to permit a representative of the assignee, at reasonably frequent intervals, to verify the outstanding assigned accounts; where an employee of the assignor is made the agent of the assignee to make the collections, and he alone made the principal in the bond; and where the applicant does not need the money to take care of his accounts payable, but can profitably use it to increase his business, the risk may be acceptable, provided an adequate premium be obtained.

CHAPTER IX.

BONDS FOR INSURANCE COMPANIES.

Sec. 146.—**Scope.** In a number of the states, it is necessary for certain classes of insurance companies, in order to get permission to transact their business in those states, to give bond with surety for the payments of the losses under their policies. The laws in the different states relating to this subject are not uniform, although all of the bonds will fall within one of the three following classes: (1) Those covering all policies *issued* during a period of one year,—a new bond being required each year; (2) those covering all *losses that accrue* during the year,—a new bond being likewise required each year; and (3) those covering all policies which may be issued and all losses that may accrue, without any limitation as to time.

Sec. 147.—**Liability—When it accrues.** It is of course apparent that an insurance company can, if it sees fit, dispute any claim that may be presented, without regard to its merits, and force the claimant to sue and get judgment; and, the surety cannot be required to pay a claim that is disputed by the principal. And, inasmuch as an insurance company must pay the judgments against it or go into the hands of a receiver, it is clear that the surety cannot be required to pay anything, so long as the principal is solvent. The insolvency of the principal is therefore a condition precedent to any liability under the bond.

Sec. 148.—**Liability—Extent of, in General.** In event an insurance company does become insolvent, the liability of the surety, under any of the three forms of bonds, would be two-fold. In the first place, the surety would have to take care of all losses, within the scope of the bond, that had not been adjusted and settled at the time of the appointment of the receiver. In the second place, the surety would have to take care of all future losses on policies then in force and covered by its bond; but this liability could be practically satisfied by reinsuring the risks with some other responsible company. The measure of liability for the outstanding insurance is therefore the cost of reinsuring it. The cost of reinsurance will depend somewhat upon the kind of insurance. In order to reinsure a life policy (where the loss is bound to occur, and the premium is paid to take care of the loss), it would be necessary to pay the reinsuring company an amount equal to the total of all the premiums that have been paid, plus interest at the rate usually earned by insurance companies. In the case of a fire or other similar policy (where the premium is paid for taking the risk of a contingency which may or may not occur) reinsurance could ordinarily be effected by paying the unearned portion of the premium; that is, the premium for such part of the time covered by the policy as had not expired.

It is however not to be assumed that the amount necessary to take care of the pending claims and to reinsure the outstanding policies, will be a total loss to the surety. Insurance companies are required by law to carry a reserve for both of these purposes; and this

reserve, together with the capital of the company, ought to take care of this liability. Although some insurance companies are lax in the matter of putting up reserves, it is fair to assume, in the absence of evidence of a contrary tendency on the part of the management, that the vigilance of the insurance commissioners in the several states will cause the companies to maintain approximately the reserves required by law. If a company does maintain its reserves, they, together with the capital of the company, would ordinarily be sufficient to take care of its liabilities; and the principal danger of loss to the surety would be the failure of the company as a result of some great catastrophe, such as a great conflagration, plague or epidemic, involving extraordinary losses.

If such a catastrophe should occur outside of the state in which the bond was filed, the principal loss, if any, under the bond would be the amount necessary to complete the reinsurance of the policies then in force in the state. If on the other hand, the catastrophe, should occur in the particular state, there would no doubt be a large number of losses to be adjusted, in addition to the reinsuring of the outstanding policies; and the full penalty of the bond would probably be consumed.

In the last analysis therefore, the contingency to be especially guarded against, is the issuance of a bond for a company that is not particularly strong and whose business in the particular state is so large that an unusual disaster in that state would probably bankrupt the company. In the case of life companies, the danger is probably negligible, as the possibility of a serious epidemic in any of the states in question is very remote,

but it is well to avoid fire companies which have a large volume of business concentrated in a single city in the state, and liability companies which have in the state large concentrated risks so that one or two accidents might bring disaster. This phase of the matter must of course be considered in connection with the strength of the company, its total business and the form of bond required.[1]

Sec. 149.—**Liability—As Affected by the Time Covered by the Bond.** Other things being equal, the desirability of any particular risk will depend upon the strength of the principal. But, inasmuch as the financial condition of an insurance company at any particular time is not necessarily a true index of what it will be in the years to come, it is apparent that a bond which will carry liability far into the future is not ordinarily a desirable risk, no matter what may be the present condition of the principal.

A bond which covers all losses that accrue in the future, without any limitation as to time, guarantees the solvency of the principal for all time, and is therefore necessarily an undesirable risk for a surety. Being an obligation in favor of the people of the state, and no method of release being provided by law, the surety would have to continue on the bond, even though disaster might be imminent. Such an indefinite guarantee with no provision for release, is not a legitimate surety risk and should be put on the prohibited list.

A bond which guarantees the payment of all losses on policies *issued* during the period of one year may

[1]See next Section.

likewise carry the liability far into the future. In life insurance, it often happens that liability on a policy does not accrue for fifty years or more after its issuance; and a surety company cannot afford to guarantee the solvency of an insurance company at the end of fifty years, or twenty-five years, or even ten years. Such risks ought likewise to go on the prohibited list. In the case of fire or casualty insurance companies, the policies are most often written to cover a period of only one year, although in some cases they do cover three or five years. While it is necessary to be cautious in guaranteeing the solvency of a company for as much as five years, yet the proposition is not necessarily impossible, and the bond may perhaps be executed for a few of the high-grade companies.

Where the bond guarantees the payment of all losses that accrue during the period of a year, liability ordinarily terminates at the end of that time; and the matter of guaranteeing the solvency of a corporation for as much as a year is of course not an extraordinary surety proposition. But under the statutes of some states, the liability on one annual bond does not terminate until another is filed; so that if a company should become insolvent during the year, or fail, at the end of the year, to give a new bond, the surety would have to stand all future losses, or reinsure all outstanding poli-
ing policies. Hence the importance, even with this form of bond, of avoiding a company whose premium income in the state is particularly large or out of proportion to its total business and its financial strength.

Sec. 150.—**Summary.** The main features of this chapter are:

(1) That the insolvency of the principal is a condition precedent to any liability.

(2) That the maximum liability is the amount necessary to take care of the pending claims, and to reinsure the outstanding policies; and that, except in cases of extraordinary catastrophes, the assets of the company are likely to be sufficient for those purposes.

(3) That the real hazard is in proportion to the probability that a catastrophe in that state would affect the solvency of the company, and, in event of insolvency, the amount of probable loss is in proportion to the premium income in the state.

(4) That only those bonds, which guarantee the payment of losses that *accrue* during the year covered by the bond, are ordinarily acceptable; although it may be reasonable, for selected companies other than life, to execute a bond covering all *policies issued* during the year covered by the bond.

CHAPTER X.

Miscellaneous Credit Guarantees.

Sec. 151.—**In General.** We have already considered certain credit guarantees, which may be required in connection with litigation, and have discussed the underwriting of bonds of that character. Those are, however, not the only credit guarantees which surety companies may be asked to issue. Application is often made for bonds which, though not needed in connection with litigation, directly guarantee the payment of money; as for example, where it is desired to guarantee that one of two joint makers of a promissory note will pay it and thereby exonerate the other. In most cases, however, the guarantee is not absolute but depends upon a contingency which may or may not happen.

Credit guarantees are often presented in the guise of contracts or mere honesty risks, so that it is often necessary to look carefully for the danger signal of credit guarantee. Any proposition that is not clearly within the scope of one of the foregoing recognized classes of bonds should be carefully examined to see whether or not the bond will directly or indirectly guarantee that the principal will pay a sum of money, either absolutely or upon a contingency. If so, the bond should be rated as a credit guarantee.

In underwriting bonds of this kind, the same general principles will apply as in the case of judicial credit guarantees, and reference is made to the appro-

priate sections.[1] For convenience, these principles may be summarized as follows:

1. A surety company cannot afford, for the small premium received, to gamble on the chance that the contingency upon which the liability depends will not happen. There is a reasonable chance that it will happen, or the bond would not be required, and the underwriter must assume it will happen.

2. Collateral security in the shape of cash or its equivalent in marketable securities to an amount equal to the greatest possible liability (generally the amount of the bond) should be required.

3. Collateral should not be waived unless the applicant is a partnership or corporation, which does not depend for its success upon any one man and which has a well established non-speculative business of at least ten years' standing; unless the concern is rated by the mercantile agencies at fifteen times the amount of the bond with the highest grade of credit and the financial statement is verified to a reasonable extent, and unless the applicant bears a first-class reputation in every respect.

4. Collateral should never be waived on the strength of outside personal indemnity, no matter how strong the indemnitors may be. Experience shows that even if they are solvent when liability accrues, they are likely to be slow in meeting the obligation, so that the surety company will be required to put up the money and await the pleasure of the indemnitors in making reimbursement, or perhaps will have to sue the indem-

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[1] See Section 76.

nitors. That subjects the surety to many chances of loss, and in any event, makes the busines unprofitable.

5. The more distant the maturity of the obligation, the greater the chance that the financial condition of the principal will change, and therefore the greater the chance of loss if the bond should be written without collateral.

In the succeeding paragraphs, some of the more important miscellaneous credit guarantees will be considered, and they will show the application of the foregoing rules or principles.

Sec. 152.—**Bond to Discharge a Mechanic's Lien.** We have seen that in many states a man who has done work or furnished material for a building may, by filing a statement of his claim on the office of a clerk of court, or other public office, obtain a lien on the building and the land upon which it stands, for the amount due[1] The law generally provides that such a lien may be discharged, and the property freed therefrom, by the giving of a bond conditioned in effect to pay the claim if it be found to constitute a valid lien. Liens of this kind are most often filed for labor and materials furnished to a contractor; and when so filed, the owner, as he has a right to do, generally declines to make further payments until his property is freed from the lien. Contractors, desiring that the regular payments under the contract shall continue, are the most frequent applicants for bonds of this kind.

Such a bond is of course a credit guarantee in that

1See Section 115.

it guarantees the payment of money; and, while the guarantee does not become operative unless the claim is held to be a valid lien, yet a surety underwriter must assume the claim is valid. The liability can safely be estimated at nothing less than the full amount of the claim, with interest and such costs, counsel fees and expenses as will probably be necessary to establish the claim as a lien; and *as an underwriting proposition,* it it is a rule of almost universal application that collateral security to that amount should be required.[1] These propositions are essentially bad because:

1. While a contractor may have a good record and may be in good standing, the very fact that he has permitted a lien to be filed against him is evidence that he is in financial difficulties or that he is over-trading. The filing of the lien should operate as a warning to the surety company to "tighten up" on the issuance of contract bonds rather than as a license to issue hazardous credit guarantees without collateral.

2. The business of a contractor is essentially speculative, so that contractors are not of the class for whom credit guarantees can safely be executed without collateral.

In practice, however, strong arguments for the issuance of these bonds without collateral are often brought to bear upon an underwriter, as for example:

1. The applicant, a contractor, may be a regular client of the company and in the habit of getting what he wants in the way of contract bonds, and may expect

[1]See Section 151.

the company to issue this bond without collateral, so that to require collateral may mean the loss of all the contractor's business.

2. It may be contended (though it is very seldom true) that the contractor in fact has ample funds to meet all just and proper claims against him, but that he genuinely and in good faith disputes the claim in question and is unable to settle it on a fair basis.

3. The company may be surety on the particular contract bond, and as such may be liable for all valid liens; and it may be that the claim in question, for the most part, is undoubtedly a valid lien, so that the issuance of the bond to discharge the lien would not materially increase the liability.

4. Though the surety company may not be liable for liens, yet it may appear that unless the contractor's regular payments are made, he will be unable to complete the contract, so that unless the bond is issued, the contractor will default and throw a loss on the surety.

These arguments will be taken up in order, the first two being considered together. It is of course manifest that it is not wise, by needlessly requiring collateral, to drive away a perfectly good client; and it may perhaps be said that where the applicant, a contractor, though he has ample funds to meet all just and valid claims, genuinely and in good faith disputes the claim in question, and is unable to settle it on a fair basis; where the applicant is worth, in net availagbe assets, fifteen times the amount of the bond, has not an excessive amount of work on hand, and is a regular and very satisfactory

client of the particular company, that company being on the contract bond in question, then it may be the part of wisdom to issue the bond without collateral if it is necessary to do so in order to retain the business of the applicant. However, if it is a *fact* that the applicant has ample funds, then he should be willing to put up as collateral the amount admitted to be due and owing. To make that requirement is a test of the applicant's sincerity and good faith and it is advised in all cases.

Where the third argument appears it may be assumed that the applicant is in financial difficulties; and the case would not be one that should even be considered as an underwriting proposition. The case then becomes one for the legal and claim departments of the company, and it is their prerogative, and not that of the underwriters, to say whether or not it is advisable thus to enable the contractor to get money which, in event of his default, would be in the hands of the owner for the benefit of the surety.

Likewise, the fourth argument would not be made unless the contractor is in financial straits and it should never induce an underwriter to issue the bond. It would be little less than foolhardy to issue the bond in that case; but, in any event, it is a matter for the legal and claim departments and not the underwriters.

Sec. 153.—**Bonds for the Payment of Rent.** Bonds which guarantee the payment of rent are very hazardous because:

1. They are clearly credit guarantees, absolutely guaranteeing the payment of money.

2. They usually cover the rent for a term of years; and before the expiration of the lease, a very strong principal may become insolvent, may die, or may "jump" his lease and dispose of his property.

3. The fact that a bond is required is generally evidence that the lessee is weak financially and cannot be depended upon to pay the rent; although in some cases, the bond is required by law, or in pursuance of a uniform rule of the lessor to require a bond in all cases regardless of the strength of the lessee.

As a rule therefore, collateral security to the full amount of the rent should be required; and it may be released in instalments as the rent is paid. Collateral may, with reasonable safety, be waived where the applicant meets the requirements heretofore laid down with reference to credit guarantees in general;[1] where the bond is required by law or in pursuance of a uniform rule of the lessor; and where the bond does not guarantee the payment of rent for a longer period than the year then next ensuing. And in some cases, where the applicant is exceptionally strong and where the bond is required by law, it may be reasonably safe to guarantee the rent for as much as two years. But in no event should the payment of rent under a lease for more than two years be guaranteed without full collateral.

Sec. 154.—**Bond to Produce Bill of Lading and Pay Freight Charges.** In ordinary course of business, it often happens that bills of lading do not reach the consignee promptly; and it being a rule of the railroads that freight will be delivered only upon the presenta-

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[1] See Section 151.

tion of the bill of lading, it is manifest that unless some satisfactory provision is made, merchants will often be delayed in receiving freight that has actually arrived at the depot. It is also very inconvenient for large merchants to be required to pay every individual freight bill before their drivers will be permitted to remove the freight. In order that their patrons may be accommodated, the railroads generally permit merchants of good standing to remove freight consigned to them promptly upon its arrival; the merchants paying the freight bills weekly or oftener and producing the bills of lading as soon as they arrive or when the freight is paid. But it is the general practice of the railroads to require the merchants to whom they grant this privilege to give bond conditioned for the prompt delivery of all bills of lading and for the prompt payment of all freight charges.

Such bonds are of course credit guarantees, and collateral would ordinarily be the rule.[1] But applicants for these bonds are usually concerns of good credit standing who can get credit of this kind without giving collateral; accordingly these bonds are generally executed by the companies, without collateral, in all cases where the applicant has a satisfactory credit rating—say $20,000 or better, first grade, but only when adequate provision is made for the protection of the surety.

There are two important provisions that should be in every such bond. The first is a provision for cancellation upon notice to the railroad. In discontinuing to grant this accommodation, the railroad is not subjected to any hardship, so it will generally consent to a

[1] See Section 151.

clause authorizing the surety to cancel upon reasonable notice, say two or three days; it being understood that the surety shall remain liable for the charges on all freight delivered prior to the expiration of that time. And secondly there ought to be a provision that in case of the non-payment of the freight charges within twenty, or at most thirty, days after delivery of the freight, the railroad will notify the surety. Bearing in mind that these bonds are not intended for the purpose of permitting an extension of credit to the principal, but only for his convenience in enabling him to remove freight promptly upon its arrival at the depot, with the understanding that he will promptly pay the charges, it is evident that if the principal does not pay promptly, the surety ought to be notified so that it may take such steps as it may deem necessary for its protection, including especially the exercising of its right to terminate the liability.

Generally each railroad has its own printed form of bond, and it is not often possible to get them to make any special exception. But the point for the underwriter to bear in mind is that in cases where the bond does not contain these two provisions, great care should be exercised and they should be executed only for very strong concerns, rated at say fifty thousand dollars, or where collateral security is obtained. As we have seen, credit guarantees which will continue in force for a long time are particularly hazardous, and as a rule can safely be executed only with collateral.[1]

Sec. 155.—**Patent Infringement Bonds.** Our pat-

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[1] See Section 151.

ent laws are such that a man may obtain letters patent on almost any device, unless substantially an exact duplicate has already been filed in the patent office; but he can seldom be sure the device is not in fact an infringement of some previous patent, until it has been so determined by the Supreme Court of the United States. And it is the law that a purchaser of an article which is an infringement of a patent may be compelled to pay to the rightful patentee a proper royalty, which would be approximately the difference between the cost of making the article and the price at which it was sold.

It often happens that there are different concerns manufacturing similar articles, each manufacturer claiming to have a patent. Where such an article is sold, the purchaser generally requires the seller to give him a bond with surety to indemnify him against loss on account of suits that may be brought against him on the ground that the article in question is an infringement of a patent.

Such bonds are considered hazardous, as they may involve the surety in litigation extending over a period of three or four years, at the end of which time the principal may be dead or insolvent, and the surety may be called upon for damages equal to the penalty of the bond. If it should be decided that the principal is not in fact the patentee of the article, it is likely to result in his bankruptcy, particularly if the manufacture of this article constitutes a substantial part of his business. It will be seen therefore that, as in all cases of

long-term credit guarantees, collateral security to the full amount of the bond should be required.[1]

In some cases, it is possible to limit the liability under the bond to any loss *sustained* during a period of, say, one year from the date of the bond, so that if the litigation should not terminate within that time, there would be no liability except for costs and expenses incurred during the year. In that event, the financial condition of the applicant is not so likely to change before the termination of the bond; and where the applicant is a well established concern, worth *exclusive of the patent rights,* ten times the amount of the bond, collateral may perhaps be waived. Where, however, there is no limitation as to time, the concern must indeed be a very strong one to justify the execution of the bond without collateral, as surety companies are seldom justified, without collateral, in writing credit guarantees where the liability may not accrue for four or five years. A mercantile credit rating, or net worth, of fifteen times the amount of the bond is requisite.

Sec. 156.—**Bond to Guarantee Payment for Merchandise to be Delivered in the Future.** Reference has been made to the case where a bond is required to guarantee the future delivery of merchandise.[2] There are also cases where a bond is required to guarantee that a contract for the sale and delivery of merchandise will be carried out, not by the party who has agreed to deliver the goods, but by the party who has agreed to accept them and pay the price. Such contracts gener-

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1See Section 151.
2See Section 118.

ally cover a continuing supply of a certain article, as for example, the output of a mill or factory. If the principal should fail to take the goods and pay the price, the surety would be required to do so. The bond is therefore in a sense, a credit guarantee; but inasmuch as goods are to be received for the money that is to be paid, it is clear that, so long as the goods are worth the price, there will be no loss under the bond. The measure of the surety's liability is therefore the possible difference between the market value of the goods at the time they are to be delivered, and the price provided by the contract. In view of the possibility that the market value of the goods may decline, it is clear that the transaction is a speculative one and that the bond should not be executed unless the principal is sufficiently strong financially to justify a reasonable expectation that he could and would stand the probable loss. If he is not, collateral security for the amount of the probable loss should be secured.

If however, the goods are to be delivered and the price paid afterward, so that the surety might be called on to pay the money without getting the goods, then the bond is a credit guarantee, and the surety should be secured against loss in the same way and to the same extent that a bank, which was loaning that amount of money for the term of the bond, would expect to be secured.[2]

Sec. 157.—**Bond of Mortgagor to make Improvements on Mortgaged Premises or to Satisfy Liens.** It

[2]See Section 151.

often happens that a man who owns a piece of land attempts to borrow the money necessary to build a house or make other improvements. If the land is of sufficient value, as compared with the value of the proposed improvements, the money to make the improvements can sometimes be borrowed on mortgage, provided the borrower will give a bond guaranteeing that he will make the proposed improvements within a specified time, to the end that the security for the loan may be adequate. Applications for such bonds are often made to surety companies, and, by executing them, the companies have sustained some severe losses, so they are not looked upon with favor under any conditions. However, there is nothing necessarily vicious about these propositions if the proper tests are applied so as to weed out the undesirable risks.

In practice, it is found that the land is rarely of sufficient value to justify a loan of the full amount necessary to erect the proposed improvements, and furthermore, the borrower is generally required to pay a considerable portion of the loan as a bonus to the lender or to the broker who negotiated the loan. The result is that the net amount of the loan is insufficient to make the improvements; and trouble has come to surety companies in cases where the borrower did not have enough money of his own to make up the deficiency, so that the surety company was required, at its own expense, to complete the building. In underwriting these bonds, it is absolutely necessary to be satisfied that the applicant has sufficient money to make the improvement, and that the money will be available for

the purpose. The safest way to reach that conclusion is to make the following requirements:

1. That the applicant let a contract for the improvement to a responsible contractor who will enter into the usual written contract with the applicant and his surety.

2. That the contractor give bond with an acceptable corporate surety, payable to the applicant and his surety, as their interests may appear, and conditioned for the completion of the contract on or before the specified time, subject to the proper penalties for delay, and subject to the same conditions (and no others) as those to which the applicant and his surety are subject.

3. That the applicant place with the surety company an amount equal to the contract price and authorize the surety company to pay the money to the contractor in accordance with the terms of the contract.

4. That the contract contain a stipulation that the plans and specifications may not be changed without the consent of the surety company, to the end that a more expensive building may not be substituted.

These requirements, if strictly followed, would seem to make the bond in favor of the mortgagee perfectly safe; and they may be considered as the standard conditions upon which these bonds may be written.

It often happens, however, that the applicant is himself a builder, and wishes to construct the building, believing he can do it for less than a contractor would charge. Bearing in mind that the troublesome cases have been those in which the borrower himself has attempted to do the work, and where the available

money was insufficient, it is clear that, in such cases, great diligence and care must be exercised to ascertain that the money is sufficient. The following requirements will generally make such a proposition as good as the ordinary contract bond:

1. That in honesty, ability, experience and equipment for the particular work, the applicant measure up to the highest standard of efficiency.

2. That the plans and specifications be submitted to a thoroughly competent and practical contractor and builder, who has the interest of the surety company at heart, and that he make an estimate of the cost of the building.

3. That the usual sub-contracts be let and that contracts be made for the material for the building, so that in reality the only thing to be estimated will be the labor, supervision and incidentals.

4. That all sub-contractors and material men, who have not satisfactory credit rating, give bond with corporate surety.

5. That the applicant place with the surety company not only an amount equal to the estimated cost of the building, but also a margin of at least ten per cent. to cover contingencies.

6. That the usual precautions as to fire and liability insurance be taken.

Under these conditions, the risk is about the same as on an ordinary contract bond—the chance of loss being in proportion to the probability that the cost of the building will exceed the estimated cost plus ten

per cent. And it is to be borne in mind that if the ten per cent. margin is not put up, the risk is just that much greater than it would be on a contract bond for the same work, as a contract price always equals the estimated cost plus about ten per cent. for profit.

In some cases, it happens that the applicant, in order to make up a deficiency of cash, will arrange with some of the sub-contractors and material men to take his note and wait for their money until the completion of the building, subordinating their claims to that of the mortgagee. In that event, the following requirements, in addition to those outlined above, should be made:

1. That the sub-contractors and material men sign written contracts with both the applicant and the surety company, so that if the applicant should default, the contract would be binding in favor of the surety company.

2. In case the principal should default and a sub-contractor should fail to comply with his contract, the surety would have to pay some one else to do the work, so that the surety's damage would be the total amount of the sub-contract, or the value of the uncompleted portion of it. It is therefore necessary, in each sub-contract, to recite the facts and to make provision that in event of default, the full amount of the contract, or the value of the uncompleted portion of it, will be the damage that will be sustained by the surety, and to insert a stipulation for the payment of that damage.

3. That the sub-contractors and material men give satisfactory bond for the performance of the contract and for the payment of the stipulated damage in case of default.

It is believed that the losses on bonds of this kind have been sustained, not because the bonds, as a class, are necessarily bad, but because the proper tests to weed out the unfit were not applied. It is necessary not only to avoid speculative builders but also the man who is attempting, in good faith perhaps, to do too much with a given amount of money. These propositions require the careful attention of an experienced man, not only in investigating the risk and making proper arrangements for the protection of the surety, but also in handling the details after the bond is executed. This means a considerable expense which should of course be borne by the applicant.

The same observations would apply to a lessee, who undertook as one of the conditions of the lease, to erect a building on the leased premises.

In some cases the money is not borrowed until after the completion of the building, though before the expiration of the time within which liens may be filed, so that a bond to pay such lien as may be filed is all that is required. In that event, the surety company will have to concern itself only with the question of outstanding bills for labor and material. Investigation ought to be made to determine the amount of the outstanding bills, a statement being obtained from each subcontractor and furnisher of material as to the amount due and a release being obtained from those who are

supposed to have been paid. Then the applicant should be required to place subject to the joint control of the surety enough money to take care of the outstanding bills, with a margin of at least ten per cent. for contingencies. The surety may permit this money to be used in payment of such bills as could be converted into valid liens; and the balance should be held until the expiration of the time for filing liens. If no liens have then been filed, the case may be closed and the balance of the money returned to the principal.

Sec. 158.—**Franchise Bonds.** In earlier times, it was quite a practice for influential citizens to obtain from a city, or other body politic, a franchise giving the right, or perhaps the exclusive right, to erect a lighting plant, a street railway or other public utility, and then hold the franchise for sale to the highest bidder. The result was that the erection of the needed public utility was often delayed. In consequence, it is now generally the practice to require of the grantee of such a franchise a bond conditioned that he will erect the utility, or cause it to be erected, and have it in operation within a specified time; and in view of the impossibility of ascertaining the damages which the public sustains by a breach of the bond, it has been uniformly held that the entire penalty of the bond is to be forfeited, as liquidated damages, in case of a breach. Such risks are necessarily hazardous because (1) the grantee of the franchise may not intend to erect the utility himself, but may contemplate a sale of the franchise to a third party; and such sale may not be effected, or if it is, the purchaser may not be able to erect the utility within the

specified time; (2) even if the grantee makes a *bona fide* effort to erect the utility, he may fail to complete it within the specified time, either from lack of funds or from causes beyond his control; and (3) if the utility is not completed within the specified time, the whole penalty of the bond will be forfeited as liquidated damages.

It would seem therefore to be necessary to require collateral security to the full amount of the bond.[1] However a fairly good substitute for collateral may be had in some cases by requiring the grantee of the franchise to let a contract for the erection of the utility to a responsible contractor; by requiring the contractor to give bond with corporate surety for the faithful performance of the contract, such bond to be made payable to the joint order of the grantee of the franchise and his surety; and by requiring the grantee to place with the surety an amount of money equal to the contract price, and to authorize the surety to pay it out in accordance with the terms of the contract.[2] In order to make such a proposition safe, it would be necessary to obligate the contractor to complete at or before the time specified in the franchise, and subject him and his surety to the same penalty for failure to complete in time as that to which the grantee of the franchise is subject. It is suggested that this method be followed wherever it is not practicable to get good collateral security.

A franchise for a public utility usually contains also a provision requiring the giving of a bond to in-

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[1]See Section 151.
[2]See Section 157.

demnify the grantor (city or county as the case may be) against any damages that may be caused in the prosecution of the work, reference being made principally to the damages that may be incurred as a result of the tearing up of the streets, roads, etc. This is a credit guarantee, and should be treated accordingly, although it may be possible for the principal to get liability insurance of such a character as to afford ample protection to him and his surety.

Sec. 159.—**License or Permit Bonds.** There are laws in the different states requiring many of those who receive licenses or permits from the state or a county or city to give bond either to indemnify the state, county or city, as the case may be, against loss as a result of the performance of the acts for which the license was granted, or to protect the public against loss. There are literally thousands of different license bonds provided for by law, including bonds of saloonkeepers, private bankers, plumbers, users of dynamite, real estate brokers and many others. The liability and risk of the surety are different in the different states, depending upon the terms of the statute, and the strictness with which it is enforced. It is manifestly impossible here to go into the details of the law in each of the states and attempt to indicate the risk of the surety. The most that can be done is to make a few general suggestions, which may perhaps be applied with more or less accuracy in each case.

1. As a rule these bonds are credit guarantees, in that they guarantee the payment of the damage that

may be sustained by the state, county or city or by the public.

2. They are none the less credit guarantees because they merely guarantee that the principal will pay over money received. There is no supervision by the state, and the chance of loss depends upon the business success of the principal, as well as upon his honesty. The bonds of private bankers, which are perhaps the most hazardous of all license bonds, are typical examples.

3. While it is not safe as a rule for a surety company to weigh the possibility that the contingency upon which liability depends will happen, yet the law does require bonds in some cases where it has been found that the probability that loss will be sustained by the state, county or city or the public is so remote as to be negligible.

4. There are only a few cases where collateral security is necessary—private bankers, for example—but in most cases the applicant should have financial strength in proportion to the nature of the business in which he is engaged, the penalty of the bond, and the chance that damage will be sustained.

5. Where the particular law, or one substantially like it, has been in force for a considerable time—say five years—and no losses have been sustained, it may be well enough to ignore the matter of financial responsibility. However, such cases are rare, for bonds are not required by law unless damage is reasonably possible.

In each case the law relating to the duties and liabilities of the licensee must be examined, and should

be considered in the light of the terms of the bond and the experience in the particular state.[1]

Sec. 160.—**Refunding Bonds.** A refunding bond, as its name indicates, is a bond which guarantees that the principal will, upon the happening of a named contingency, pay back a sum of money he has received. It is possible to conceive of any number of circumstances under which such bonds may be required. There may be, for example, two claimants to a fund in the hands of a third person, and such third person may be willing to deliver it to one of them, provided that one will give a bond to return the money in case it be subsequently shown that the fund belonged, in fact, to the other. Or a fiduciary, feeling that there is some doubt about the right of a certain person to receive a distributive share of the estate, may nevertheless be willing to make the distribution to him, provided he will give a bond to return the property in case it be found that he was not entitled to it. Such bonds are nearly always required by the administrator of the estate of a man who is not known to be dead, but whose death has been presumed from long absence.

In practically all of such cases, the bond is a credit guarantee, in that it guarantees the payment of money in case the contingency mentioned in the bond should happen. The risk is of course in proportion to the probability that the contingency will happen; but, as we have seen, it is not the province of a bonding company to weigh this probability for it must be remembered that in these, as in all other cases of suretyship, the pre-

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[1] See Section 151.

mium is paid merely for the use of the surety's name and credit, and not for taking the risk that the contingency will happen. On bonds of this kind, collateral should be the rule.[1]

Sec. 161.—**Bond for Deportation of Immigrants.** Congress has provided that any alien who shall enter the United States in violation of law and such as shall likely become a public charge from causes existing prior to landing, shall be taken into custody and deported to the country whence he came at any time within three years from the date of entry; provided that pending the final disposal of the case of an alien so taken into custody, he may be released under a bond in the penalty of not less that five hundred dollars conditioned that such alien shall be produced when required for a hearing in regard to the charge upon which he has been taken into custody, and for deportation if he shall be found to be unlawfully within the United States. (Act Feb. 20, 1907, ch. 1134, Sec. 20.).

Such a bond is in effect a bail bond,[1] in that it guarantees that the principal will appear to answer what is in effect a criminal charge, and one for which he may be deported; and in that, the whole penalty of the bond will be forfeited in case of his failure to appear. A surety company cannot of course take the risk that an immigrant, when once admitted to this country, will voluntarily put himself in a position to be deported; and it follows that collateral security to the full amount of the bond should always be required.

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[1]See Section 151.
[1]See Section 95.

Sec. 162.—**Bond of Indemnity Against Immigrant Becoming a Public Charge.** Any alien who is liable to be excluded because likely to become a public charge or because of physical disability other than tuberculosis or a loathsome or dangerous contagious disease, may, if otherwise admissable, nevertheless be admitted, in the discretion of the Secretary of Commerce and Labor, upon the giving of a bond conditioned to hold the United States, or any state, territory, county, municipality or district thereof, harmless against such alien becoming a public charge. (Act Feb. 20, 1907, C. 1134, Sec. 26.).

If any particular immigrant is, in the opinion of the immigration officers, likely to become a public charge, then manifestly a surety company cannot, without collateral security to the full amount of the bond, guarantee that he will not become a public charge. As we have seen, it is not the business of a surety company to take risks of that sort; the premium being merely for the use of the surety's name and credit. And if the immigrant should become a public charge, the whole penalty of the bond would no doubt be exhausted, so that collateral security to the full amount of the bond should always be required. It would seem that such collateral would have to be retained for quite a long time,—if indeed it could ever be released; for it is practically impossible to say with certainty when the possibility that an immigrant will become a public charge has passed.

CHAPTER XI.

INTERNAL REVENUE BONDS.

Sec. 163.—**Scope.** In order to insure the collection of the internal revenue to which the Federal Government is by law entitled, many of those whose duty it is to pay those taxes are required to give bond, with surety, conditioned in effect that they will perform their duty in this respect. Internal revenue taxes are levied mainly on liquors and tobacco, so that manufacturers of, and dealers in, those articles are the prinicpal ones who are required to give such bonds. These bonds are undoubtedly credit guarantees, in that they guarantee the payment of money; yet the collection of the taxes is surrounded by so many safeguards, and the penalties for failure are so burdensome that a loss seldom occurs.

In the preceding chapters, we have been dealing with bonds where the liability varied according to the law of the several states, or according to the different forms of bonds of the several companies. It has not been possible, therefore, to point out specifically the liability in each case; but it has been necessary, by induction, to formulate general principles from which it is hoped the liability under any particular bond may be determined. The bonds which are the subject of this chapter, being required by Federal authority, are uniform throughout the country, so it will be possible to consider the specific liability and risk under each bond. While the question whether or not a particular applicant is able and willing to perform the obligation thus outlined will be deter-

mined, in a measure, in accordance with the principles heretofore announced, yet some specific suggestions will be made with regard to the chance of loss under each bond.

It seems unnecessary, however, to attempt to point out the risk on all the bonds that may be required in this connection, as some of them are used very infrequently, and some involve practically no chance of loss. We shall deal therefore only with those which are used most frequently.

The bonds of the internal revenue officers are not within the scope of this chapter; they are public official bonds and should be considered in the light of Chapter II. This chapter is limited to the bonds required to be given by manufacturers of and dealers in articles subject to an internal revenue tax.

Sec. 164.—**Distillers' Bonds.** An internal revenue tax is, by law, imposed on all distilled spirits; and, inasmuch as it would be compartively easy for a distiller, if left free to act upon his own inclination, to dispose of the liquors distilled by him, without paying the tax, Congress has made elaborate provision to insure the payment of the taxes when due.

The law provides, in the first place, that, if any person engages in, or carries on, the business of a distiller with intent to defraud the United States of the tax on the spirits distilled by him, "all distilled spirits or wines, and all stills or other apparatus used or intended to be used for the distillation or rectification of spirits, * * * found in the distillery * * * and all right title and interest of such person in the lot or tract of land on

which such distillery is situated, and all right, title and interest therein of every person, who knowingly has suffered or permitted the business of a distiller to be there carried on, or has connived at the same * * * shall be forfeited to the United States.'' (R. S. Sec. 3281.) In order to make sure that the lien, imposed by Sec. 3281, will operate on the land, and to prevent the owner of the land (if he be not the distiller) from contending that he was ignorant of the purpose for which the property was to be used, the law further provides that a person shall not engage in the business of a distiller ''unless he is the owner in fee, unencumbered by any mortgage, judgment or other lien, of the lot or tract of land on which the distillery is situated; or, unless he files with the collector the written consent of the owner of the fee or of any mortgage or judgment creditor * * * that the premises may be used for the purpose of distilling spirits * * * and expressly stipulating that the lien of the United States for taxes and penalties shall have priority.'' (R. S. Sec. 3263.)

The law not only imposes these heavy penalties for any attempt to evade the internal revenue laws, but it imposes restrictions, which if carefully and properly enforced, will go far toward preventing the distiller from avoiding the payment of the tax.

It is provided that the process of distillation is to be carried on through continuous closed vessels and pipes; that the distiller must furnish the Commissioner of Internal Revenue a plan of the distillery showing the location of the vessels and pipes; and that at the end of each day, and before midnight, all spirits distilled

during the day must be conveyed to receiving cisterns, which are in charge of and under the lock of an internal revenue officer known as a gauger, and can be opened only in his presence. Afterward the spirits are to be withdrawn, under the supervision of the gauger, from the cisterns into casks or barrels. Then the spirits are to be gauged, proved and marked, and immediately removed into the distillery warehouse, which is required to be maintained by the distiller on the distillery premises to be used only for the storage of distilled spirits of his own manufacture, and which is in charge of an internal revenue officer known as a storekeeper. The storekeeper has joint custody with the distiller, and the law provides that the warehouse shall at no time be unlocked, or opened or remain open unless in the presence of the storekeeper.

In addition to these precautions, each distiller is required to give a bond (Government Form 30) conditioned that he will in all respects faithfully comply with all the provisions of law relating to the duties and business of distillers and pay all penalties incurred or fines imposed on him for a violation of any of the said provisions, and that he will not suffer the tract of land on which the distillery stands, or any part thereof, or any of the distilling apparatus to be encumbered by mortgage, judgment or other lien. (R. S. Sec. 3260.) A new bond is required to be executed on the first day of May each year.

The effect of this bond is to guarantee that all spirits that may be distilled will be put in the distillery warehouse; and the distiller is required to give

another bond conditioned in effect that the proper taxes will be paid on all spirits deposited in the distillery warehouse. This bond is called the distillers' warehousing bond; and may be given monthly (Form 80) conditioned to pay the tax on all spirits deposited during the preceding month, or may be given annually (Form 359) conditioned to pay the tax on all spirits deposited during the year, such payments to be made within eight years from the date of entry of such spirits for deposit in the warehouse. This bond continues in force until all the spirits deposited during the month or year, as the case may be, have been lawfully withdrawn from the warehouse; and if they are not withdrawn within eight years they may be sold for the payment of the tax.

Now it will be seen that if the gauger and storekeeper, both of whom are required to give bond for the faithful performance of their duties, comply with the law, there is little chance for the distiller to dispose of his product without paying the tax. Practically the only chance is to draw off some of the spirits by "tapping" the pipes or by other similar means. But in view of the forfeiture of property heretofore mentioned, and of the further fact that the law provides a penalty of fine up to $5,000 and imprisonment for not less than three months nor more than three years "whenever any person removes, or aids or abets in the removal of any distilled spirits, on which the tax has not been paid, to a place other than the distillery warehouse provided by law, or conceals or aids in the concealment of any spirits so removed" (R. S. Sec. 3296), it may be assumed that where a distiller has an established reputa-

tion and standing, and where the distillery is of considerable value, he will not attempt to avoid the payment of the tax. That has been the experience of the companies, and where a distiller is rated at ten to twenty thousand dollars, the bonds may be executed without hesitation. However there are many distillers who do not come up to these requirements, and they present the difficult cases for an underwriter. In the South, particularly, there are many small distilleries—some of them little better than the famous illicit "stills"—which are of little value, and the owners of which have little or no other property. It has been found that such distillers will try once in a while to defraud the Government, and they often impose a liability upon their sureties. If the distillery has a capacity of thirty gallons of proof spirits or less per day, the distiller may be exempted from the requirement that the process of distillation shall be carried on through continuous closed vessels or pipes, and is not required to furnish a plan of his distillery, so that such a distiller may more easily evade the payment of the tax. It has been found that attempts to evade the law are most often made where the owner of the distillery owns or operates one or more saloons. In that event the risk is extra-hazardous, for he is very apt to use in the saloons some liquor on which the tax has not been paid. Distillers rated at less than the figures above mentioned are not particularly desirable risks, but bonds for them can, with comparative safety, be written where:

1. The people owning and operating the distillery have clear records and a good standing in the community.

2. Where the distillery has been established say five years, and is worth from three to five thousand dollars.

3. Where the distillery is not in a section where people are in the habit of trying to evade the revenue laws. This is a very important consideration.

4. Where the distillers do not directly or indirectly own or operate any saloons. Careful investigation should be made on this point.

Sec. 165.—**Fruit Distillers' Bonds.** Liquor distilled from fruit, as well as that distilled from grain, is subject to an internal revenue tax; and a distiller of fruit brandy is required to give a bond (form 30½) conditioned that he will faithfully comply with all the provisions of law and regulations in relation to the duties and business of distillers of brandy from apples, peaches, grapes, pears, pineapples, oranges, apricots, berries, prunes, figs or cherries exclusively, and will pay all penalties incurred or fines imposed on him for a violation of any of the said provisions. The effect of this bond is to guarantee that the internal revenue tax on all brandy produced by the principal will be paid. He may pay the tax each month as the brandy is produced, or he may, after it has been properly gauged, marked, branded and stamped, cause it to be removed to a special bonded warehouse. In that event he need not pay the tax until the brandy is taken from the warehouse; but in order to acquire the right thus to put brandy in a special bonded warehouse and delay the payment of the tax, he will be required to give another bond (form 235—transportation and warehousing bond)

conditioned that, as to all brandy removed from the distillery for deposit in any special bonded warehouse, he will safely transport the same to and deposit it in the special bonded warehouse, within the time and in the manner required by law and regulations; that he will likewise, upon the removal of said brandy from the special bonded warehouse for deposit in another, safely transport the same to and deposit it in the warehouse in which the deposit is to be made; and will well and truly pay the tax imposed by law, or cause the same to be paid, within eight years from the date of the original gauge and before withdrawal. This bond covers all brandy removed during the current fiscal year ending June 30th, and a new bond is required each year. Each bond continues in force until all the brandy deposited in the warehouse during the year has been lawfully withdrawn.

As in the case of distillers of spirits, there is practically no chance to avoid paying the tax after the brandy has once been put in a warehouse, as the storekeeper will see to it that the brandy is not removed until the tax is paid, and, if the distiller does not pay the tax within eight years, the brandy may be sold by the collector, and it will always bring enough to pay the tax. Likewise there is little danger that, after the distiller has entered brandy for deposit in a bonded warehouse, he will attempt to dispose of it without paying the tax, as the attempt would almost immediately come to the attention of the internal revenue officers, and he would have to suffer the consequences. The chance of loss under the warehousing bond (Form 235) is there-

fore rather remote. The other (Form 30½) is the hazardous bond, in that it covers the contingency that the distiller may dispose of some of the brandy without paying the tax and without entering it for deposit in a bonded warehouse; and it would be comparatively easy for him to do this, as there is no internal revenue officer to exercise control over the brandy, until it is entered for deposit in such a warehouse. It is true that a penalty of fine up to $5,000 and imprisonment up to three years is imposed for any act that would be a breach of the bond; but no forfeiture of property is provided for by law, nor is the distiller required by law to be the owner of the property on which the distillery is located. Although the internal revenue collector is expected to see that no license is issued unless the licensee is the sole owner of the distillery, yet there are cases where the bond of some person, who was in no way interested in the distillery, has been accepted.

As a class therefore these bonds are more hazardous than those of distillers of spirits, for there are many of such distilleries, and most of them are small and in remote sections; and as we have seen, the supervision of the internal revenue officer is much less thorough. However by applying the same tests as to distillers of spirits,[1] the undesirable risks can, with fair accuracy, be eliminated. In this connection it is especially important to note the third requirement. In California where the business is conducted on a large scale, and where the payment of the internal revenue tax is taken as a mat-

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[1]See Section 164.

ter of course, there have been very few, if any, attempts to evade the law. On the other hand, in Ohio, New York and some other places, where the business is on a small scale, attempts to defraud the government are more frequently made. A good deal depends upon the temper of the people in the particular locality, and careful investigation ought to be made along that line. If in the particular section there is any evidence of a disposition to evade the law, the bond ought to be executed only where the applicant has unencumbered real estate worth the amount of the bond, or where satisfactory indemnity from the owners of real estate is received.

Sec. 166.—**Transportation and Warehousing Bond.** We have just seen that where a distiller of fruit brandy enters such brandy for deposit in a special bonded warehouse, he must give a transportation and warehousing bond (Form 235) conditioned in substance that he will safely transport the brandy to, and deposit it in, the special bonded warehouse and that he will pay the tax imposed by law within eight years from the date of the original gauge and before withdrawal.[1] A distiller of spirits is required to give a similar bond (Form 351) in case he desires to remove the spirits from his distillery warehouse to a general bonded warehouse; the bond being conditioned that he will safely transport the spirits to and deposit the same in the general bonded warehouse, and that he will pay the tax imposed by law or cause the same to be paid within eight years from the date of the original entry for deposit in his

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[1]See Section 165.

distillery warehouse and before withdrawal. These bonds cover all the spirits removed during the current fiscal year ending June 30, and a new bond must be given each year. These bonds have not been found hazardous, for the reason perhaps that distillers are not so foolish as to atempt to divert the spirits from the warehouse to which they are to be removed when it is certain such diversion will almost immediately be discovered and in all probability they will be sent to the penitentiary. After the spirits are put in the warehouse, the payment of the tax is not a matter that need give the surety any concern, for if the distiller does not pay the tax within eight years, the collector may sell the spirits, and they will always bring the amount of the tax. These bonds may be written for any distiller of good standing.

Sec. 167.—**Bond of Proprietor of a General or Special Bonded Warehouse.** We have seen that a distiller of spirits may remove his product from his distillery warehouse to a general bonded warehouse, and that a distiller of fruit brandy may deposit the brandy in a special bonded warehouse. The internal revenue collector of each district designates these warehouses. He may designate one or more, but not more than ten, warehouses in his district as general bonded warehouses for the storage of distilled spirits, and one or more, but not more than ten, as special bonded warehouses for the storage of fruit brandy. The proprietor of each of such warehouses is required to give a bond conditioned in effect that he will not permit any of the liquor lawfully stored therein to be withdrawn except upon the permit of the

collector of internal revenue; and when the permit is issued, the tax will have been paid. These bonds, though continuous, are not hazardous, for the reason, as we have seen, that each such warehouse is in joint custody of the proprietor and a government storekeeper, that it cannot be opened except in the presence of the storekeeper, and that the storekeeper is required to give bond for the faithful performance of his duties.[1] Besides, these warehouses are usually quite valuable; and that of course serves as a protection to the surety. These bonds may be written in practically all cases without outside indemnity or collateral.

Sec. 168.—**Bond for Exportation of Distilled Spirits.** The internal revenue tax on distilled spirits is required to be paid only in the event the liquor is to be consumed in this country. When therefore distilled spirits are to be exported, the distiller may remove them from the warehouse without paying the tax, but in order to get the permission of the collector to do so, he must, among other things, give a bond (Form 548) conditioned that the spirits shall be delivered on board ship (or cars, where the transportation is to be made by rail) on the arrival of the spirits at the port and within sixty days from the date of the bond, and that within fifteen days from the date of delivery, he will produce to the collector satisfactory proof that the spirits have been so delivered, and duly inspected, entered, bonded and cleared, and that he will pay the tax on the deficiency, if any.

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[1] See Section 164.

These bonds, like the transportation bonds,[1] have not been found hazardous, and may be written with the same freedom. Liability terminates at the end of 75 days.

Sec. 169.—**Bond for the Withdrawal of Alcohol Free of Tax, Under Sec. 3297, R. S.** The law provides that alcohol may be withdrawn from bonded warehouses, without the payment of any tax, when it is to be used for the sole purpose of preserving specimens of anatomy, physiology, or natural history belonging to certain classes of institutions, or for the sole purpose of use in the chemical laboratory of such institutions. But the institution is required to give bond conditioned that the entire quantity of alcohol, so withdrawn, shall be used by the institution, or the proper officer thereof, for the purposes above specified, and for no other purpose; and that the principal will produce, within twenty-four months, to the collector of internal revenue for the proper district, proof satisfactory to that officer, and to the Commissioner of Internal Revenue, that the alcohol has been so used. The bond further provides that, in case the alcohol, or any part thereof, shall be used for any purpose other than that above specified, the principal will pay, or cause to be paid, the tax on the whole quantity of alcohol withdrawn from bond, together with a like amount, in addition, as a penalty.

The danger, under this bond, is that someone will use the name of an institution as a cloak to evade the payment of the tax on alcohol to be used for purposes not within the scope and intent of the law. It is there-

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[1]See Section 166.

fore necessary to be reasonably certain that the institution is in good standing and in need of alcohol for the purposes specified in the act; that the individuals who desire to withdraw the alcohol, in the name of the institution, are connected, in a proper official capacity, with the institution; and that they intend to use the alcohol for the purposes specified in the act. If so the bond may, with reasonable safety, be executed; especially since institutions of this kind usually have considerable property. The collector of internal revenue is required to make an investigation as to the purpose for which the alcohol is to be used; and if he is not satisfied that it will be used for a proper purpose, he may refuse to issue the permit. This of course serves as a protection to the surety; and where the bond is small, an independent investigation by the surety is hardly necessary; but where the bond is large the surety should, for itself, make an investigation in the particulars above specified.

Sec. 170.—**Bond for Withdrawal of Distilled Spirits Free of Tax Under Section 3464 R. S.** When distilled spirits are sold to any officer or department of the Federal Government for the use of the Government, the internal revenue tax is of course not required to be paid. But before a distiller can withdraw the spirits from the warehouse, free of tax for delivery to a Government officer, he must among other things, give bond (Form 544) conditioned that he will safely deliver the spirits or cause them to be delivered to a named officer at a named place and that he will within 30 days furnish to the collector a certificate of the named officer showing

the due delivery of the spirits to him. In event of his failure so to deliver the spirits, he and his surety are obligated to pay the tax on all such spirits so withdrawn and not so delivered. The risk under this bond is about the same as under the bond referred to in the preceding section and may be written under the same conditions.

Sec. 171.—**Denatured Alcohol Bonds. In general.** Under an Act of Congress of June 7, 1906, domestic alcohol may be withdrawn from bonded warehouses, without the payment of the internal revenue tax, for use in the arts and industries, and for fuel, light and power, provided the alcohol shall have been denatured, so as to destroy its character as a beverage and render it unfit for liquid medicinal purposes. Under the original Act, the denaturing could be done only upon application of a registered distillery in denaturing bonded warehouses specially designated for denaturing purposes only; but, by an amendment of March 2, 1907, the commissioner of internal revenue may authorize the establishment of central denaturing bonded warehouses, other than those at distilleries, to which alcohol may be transferred from distilleries or distillery bonded warehouses, without the payment of the internal revenue tax, and in which such alcohol may be stored and denatured.

In order to prevent this law from being used as a means of avoiding the payment of the internal revenue tax on alcohol, which is not in fact to be denatured for the purposes mentioned in the act, the several persons who are authorized to handle denatured alcohol are

required to give bond. These bonds will be separately considered.

It is proper, however, at this point, to call attention to the fact that Section 2 of the Act provides in substance that any person who withdraws alcohol free of tax, under the act, and removes or conceals the same for the purpose of preventing it from being denatured; and any person who uses alcohol, withdrawn from bond under the act, for manufacturing any beverage or liquid medicinal preparation, or knowingly violates any of the provisions of the act, shall on conviction be fined not more than $5,000.00 or be imprisoned not more than five years or both. In addition, any person so convicted must forfeit to the United States all personal property used in connection with the business, together with the building and lots of ground constituting the premises on which said unlawful acts are performed or permitted to be performed.

Any breach of the condition of any of the bonds required in pursuance of this act would no doubt come within the scope of the prohibitions of Section 2; and, in estimating the chance of loss, the probable punishment and forfeiture are to be taken into consideration.

Sec. 172.—**Distiller's Denaturing Warehouse Bond.** (Form 572.) Every distiller, who establishes a denaturing warehouse on his distillery premises, is required to give a bond conditioned that he will well and faithfully comply with all requirements of the act aforesaid, and regulations issued pursuant to said act, respecting the withdrawal, transfer, and denaturation of alcohol or rum, and will perform all other acts and ren-

der such reports as may be required by said act and regulations; will pay on demand the tax of one dollar and ten cents on each and every proof gallon of alcohol or rum withdrawn for transfer to said denaturing warehouse as to which all requirements of said act or regulations are not fully complied with; and will likewise pay all penalties incurred and all fines imposed on him for a violation of any of the provisions of said act.

The essence of this obligation is that the distiller will not, under cover of the act, withdraw alcohol from his distillery warehouse without denaturing it in the manner provided by law. Having in view the usual value of a distillery, the fine, imprisonment and forfeiture provided for by the act, and the close supervision exercised by the Internal Revenue Department, it may be said to be highly improbable that there will ever be a substantial violation of one of these bonds; and the chances are that a merely technical violation, with regard to reports for example, would not be enforced against the surety.

Sec. 173.—**Bond for Central Denaturing Bonded Warehouse.** (Form 611). One who, under the amendatory act of March 2, 1907, establishes a central denaturing warehouse is required to give a bond similar to that required of a distiller who establishes a denaturing warehouse on his distillery premises. The liability and the hazard are substantially the same in both cases.

Sec. 174.—**Industrial Distiller's Bond.** (Form 614). Under the Act of March 2, 1907, distilleries for the manufacture of alcohol for denaturing only may be established. Such a distillery is classed by regulation

as an industrial distillery; and the proprietor is authorized to denature the alcohol himself or send it to a central denaturing warehouse for that purpose. He is required to give a bond conditioned in substance that he will safely keep the alcohol so manufactured until it is denatured or put in transit to a central denaturing bonded warehouse; that he will account for all the alcohol manufactured by him in a record provided for that purpose, and that he will denature, in accordance with law and regulations, all the alcohol that he may select and set aside for that purpose. The essence of this obligation is that all alcohol manufactured by him, must be denatured either by himself or by a central denaturing bonded warehouse.

The hazard under this bond would seem to be no greater than under a distiller's denaturing warehouse bond.[1]

Sec. 175.—**Transportation and Storeroom Bond.** (Form 653). In order that consumers of denatured alcohol may conveniently get it in quantities suitable to their needs, it has been provided by regulation that such alcohol may be removed, by dealers, from denaturing warehouses and placed in storerooms specially set apart for that purpose and held for sale to manufacturers authorized to procure and use such alcohol for manufacturing purposes. In order for a dealer to get permission thus to remove denatured alcohol to his storeroom, he must give a bond conditioned, in substance, that, as to all such alcohol so removed, he will

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[1]See Section 172.

cause the same to be safely transported to his storeroom, and that he will safely store the same therein until lawfully disposed of. In event of his failure so to do, the bond provides that he shall pay one dollar and ten cents on each proof gallon, together with a like amount, in addition, as a penalty. He would of course likewise be subject to the penalties and forfeiture provided in Section 2.

The risk under this bond is that the dealer will dispose of the alcohol to persons not authorized by law to use it. But his premises are likely to be of some considerable value; and, in view of the penalties and forfeiture above referred to, the chance that he will do so would seem to be slight. Beside, he would probably not proceed very far with such illicit sale before being discovered by the Internal Revenue Department.

Sec. 176.—**Manufacturers' Bond for Specially Denatured Alcohol.** (Form 582). In order for a manufacturer to acquire the right to use alcohol which has been withdrawn from bond free of tax and denatured, he must, among other things, give a bond, which, after specifying the denaturer or dealer from whom such alcohol is to be obtained, is conditioned, in effect, that the entire quantity of alcohol so obtained will be used for the purpose of manufacturing the specified article and for no other purpose. In case the alcohol should be diverted from the specified purpose, the penalty imposed by the bond is the payment of the internal revenue tax of one dollar and ten cents per gallon on all the alcohol so diverted. However such diversion would be a breach of Section 2 of the act and would subject the

principal to the penalties and forfeiture therein specified.

It would seem to be highly improbable that any *bona fide* manufacturer (who must, of necessity, have an equipment of some considerable value) would, for the comparatively small profit he could make out of a diversion of the alcohol, lay himself open to the penalties and forfeiture provided by law. This bond is the one most frequently needed in connection with denatured alcohol; and it would seem that it might be safely issued for any manufacturer legitimately engaged in the making of an article requiring the use of denatured alcohol.

Sec. 177.—**Brewer's Bond.** Fermented liquors are subject to an internal revenue tax of $1.10 on every barrel of thirty-one gallons; and every brewer, before commencing or continuing business, must execute a bond to the United States, to be approved by the Internal Revenue Collector, in an amount equal to three times the amount of the tax on the liquors brewed by him during the period of a month, and conditioned that he will "pay or cause to be paid, as provided by law, the tax required by law on all beer, lager-beer, ale, porter, and other fermented liquors made by him, or for him, before the same shall be sold or removed for consumption or sale, except when removed as provided by law; and shall keep, or cause to be kept, a book, in the manner and for the purpose specified by law, which shall be open to inspection by the proper officers as by law required; and shall in all respects faithfully comply, without fraud or evasion, with all requirements

of law relating to the manufacture and sale of any malt liquors." (R. S. Sec. 3336.) A new bond must be executed once in every four years; and upon the execution of a new bond, liability under the former bond terminates, except as to defaults committed during the four years it was in force.

The payment of the tax by brewers is not surrounded by so many safeguards as is the case with distillers,[1] there being no specific lien on the land and the period of imprisonment not being so long; but the law does provide that every brewer shall render to the collector monthly a sworn statement of the estimated quantity of liquors brewed and the actual quantity sold or removed, and further provides that any brewer, who attempts to evade the payment of the tax on fermented liquors or who fails to do any of the things required by law, shall forfeit all the liquors made by him or for him, and all vessels, utensils and apparatus used in making same, and shall be subject to a penalty of not less than five hundred dollars, and imprisonment for a term not exceeding one year. (R S. Sec. 3340.) The tax is required to be paid by means of stamps which must be purchased from the collector and affixed upon the spigot hole in the head of every receptacle in which the liquor is contained, and the same penalty is imposed for selling the liquor before the receptacle has been properly stamped or for using false stamps. (R. S. Secs. 3343-44-46.)

In view of these penalties, and the value of the usual brewery, it would naturally be assumed that there

[1] See Section 164.

would be few, if any, losses under these bonds; and that has been the experience of the companies. These bonds may be executed for any concern which is in good standing and has a fair credit rating or which is the owner of the brewery and the land upon which it is situated, even though the property may be mortgaged for as much as sixty per cent. of its value.

Sec. 178.—**Bond for the Exportation of Fermented Liquors.** Under an act of Congress passed June 8, 1890, the internal revenue tax need not be paid on such fermented liquors as shall be exported to a place without the jurisdiction of the United States; but, in order to get the right thus to export such liquors without paying the tax, the brewer must, among other things, give a bond (Form 263) conditioned that as to all fermented liquor removed from the brewery or other place of storage for exportation, he will comply with all the requirements of the said Act of Congress and the regulations issued pursuant thereto; and that he will furnish to the Collector of Internal Revenue, within ninety days from the date of such removal, satisfactory evidence that said liquor has been duly entered for export and actually cleared for a port or place without the jurisdiction of the United States. In case of failure to comply with the bond, the principal and surety will be liable for double the amount of the tax on the liquor; but inasmuch as the liability accrues within ninety days, at the end of which time, the failure to export the liquor will become known, it may be assumed that no reputable brewer would try to divert the liquor and subject himself to probable fine and imprisonment, and

double the ordinary tax. Such bond may be issued for any reputable brewer or brewing company.

Sec. 179.—**Bond for Exportation of Specific Merchandise under the Internal Revenue Laws.** We have seen that when distilled spirits or fermented liquors are exported from this country no internal revenue tax is required to be paid. The same is true of tobacco, snuff, cigars and other articles which are ordinarily subject to an internal revenue tax. Any manufacturer engaged in the business of exporting such merchandise from the United States without paying the tax, must among other things, give bond (Form 549) conditioned that the articles so manufactured and removed for export shall be duly consigned to a collector of customs, and shall upon the receipt thereof by such collector, be entered for export from the United States, and that, within 90 days from the date of each such removal for exportation, he will produce to the collector the proof required by the regulations of the Treasury Department, showing that the articles so removed have been duly laden on a foreign bound vessel or car, and that the said articles were actually cleared for a foreign port. In the case of all articles except tobacco, snuff, cigars and playing cards, there is an added condition that the principal shall produce satisfactory evidence that the articles have actually been landed at a port without the jurisdiction of the United States, or that after shipment they were lost at sea without fraud or negligence of the owner or shipper. The obligation to produce the proofs to the collector is not a serious or difficult matter, if in fact the merchandise has been ex-

ported. The only danger is that the principal will not export the merchandise but will divert it from its supposed destination, with a view of avoiding the payment of the tax, or will have it relanded at some other place. In practice however this has been found not to be a serious risk.

The close supervision and vigilance of the Internal Revenue Department would probably make any such attempt futile, and inasmuch as it would subject the man making the attempt to fine and imprisonment, it is hardly ever attempted, especially when bond with corporate surety has been given.

Sec. 180.—**Cigar Manufacturer's Bond.** A cigar manufacturer is required to give a bond (Form 71) conditioned that he shall "comply with all the requirements of law in regard to the manufacture of cigars, and shall not engage in any attempt, by himself or by collusion with others, to defraud the Government of any tax on his manufactures, and shall render truly and correctly, all the returns, statements, and inventories prescribed; and whenever he shall add to the number of cigar makers employed by him, shall immediately give notice thereof to the collector of the district, and shall stamp, in accordance with law, all cigars manufactured by him before he offers the same, or any part thereof, for sale, and before he removes any part thereof from the place of manufacture, and shall not knowingly sell, purchase, expose, or receive for sale, any cigars which have not been stamped as required by law." (R. S. Sec. 3387.) This bond must be in a sum of not less than $2,000.00 nor more than $20,000.00,

and is continuous, remaining in force as long as the license. The only way the bond can be terminated while the principal continues in business is for the Internal Revenue Collector to check up his stock, revoke his license, issue a new one and require a new bond.

The penalties provided by law, in case of a breach of the bond, are imprisonment for not less than six months nor more than two years, and forfeiture to the United States of "all raw material and manufactured, or partly manufactured, tobacco and snuff, and all machinery, tools, implements, apparatus, fixtures, boxes, barrels and all other material which may be found in his possession in his manufactory or elsewhere." (R. S. Sec. 3372.)

In view of this penalty, and of the close supervision exercised by the internal revenue officers, few, if any, *bona fide* manufacturers attempt to evade the internal revenue law; and where an applicant for such a bond has enough money or property to warant the assumption that he is acting in good faith and bears a good reputation, the bond may be issued.

Sec. 181.—**Tobacco Manufacturer's Bond.** Manufacturers of tobacco are required to give a bond (Form 40) similar in tenor and effect to that required to be given by a cigar manufacturer, and the liability and risk of the surety are substantially the same.

Sec. 182.—**Tobacco Peddler's Bond.** A tobacco peddler, as the name implies, is one who goes about the country selling and immediately delivering tobacco and cigars direct to consumers. In order to prevent such a peddler from handling tobacco on which the internal

revenue tax has not been paid, he is required, among other things, to get a license from the internal revenue collector and give bond conditioned that he will not engage in any attempt, by himself or by collusion with others, to defraud the Government of any tax on tobacco, snuff or cigars; that he will neither sell nor offer for sale any tobacco, snuff or cigars except in original or full packages, as the law requires the same to be put up and prepared by the manufacturer for sale, and except such packages of tobacco, snuff or cigars as bear the manufacturer's label or caution notice and his legal marks or brands and genuine internal revenue stamps which have never before been used.

Inasmuch as such peddlers go about from place to place, taking their goods with them, it is of course impossible for the internal revenue officers to exercise much, if any, supervision over them; and inasmuch as they generally have little or no property, except perhaps a horse and wagon, there is really nothing to prevent these peddlers from handling tobacco on which the internal revenue tax has not been paid. However, the law does provide a penalty of fine up to $500 and imprisonment up to one year for any act that would result in a breach of the bond.

In practice these bonds have been found not to involve much chance of loss. It is not certain whether this is because the peddlers do not in fact violate the law or because the violation is not discovered. In any event these bonds are considered desirable business, and may be accepted whenever the investigation shows the applicant to have a good record. The bond is continu-

ous, but a new license is required each year, so that if the license is not renewed, the bond may be cancelled.

CHAPTER XII.

CUSTOM-HOUSE BONDS.

Sec. 183.—**In General.** Many different kinds of bonds are required by the Treasury Department of the Federal Government, in connection with the collection of customs duties on imports. These bonds, for the most part, guarantee the payment of import duties on merchandise, or that the merchandise will be exported out of the country, or that it will be taken to another port and there entered for the payment of duty. There are, however, other miscellaneous bonds, which are required and given in this connection. There are bonds which guarantee that imported merchandise will be used for a specific purpose, which renders it non-dutiable; that merchandise will be held pending an examination by the customs authorities, or that it will be re-delivered upon demand of the collector; that certain specified documents will be produced; that damages sustained by the Government will be paid and that the Government will be reimbursed for expenses in connection with the importation of merchandise, etc.

It appears to be a fact that there have been very few, if any, actual losses under these bonds in the past; and as a class they impose on the surety very little actual hazard, although in some cases there is considerable risk, and in a few cases collateral security is necessary. These bonds are not specifically provided for by any statute, are printed only in book form, can be signed only at the custom houses, and no copies are

available; hence it is difficult for a prospective surety to obtain information, in advance, as to the nature of any obligation of this kind he may be asked to assume. As in the case of internal revenue bonds, it will be my purpose to refer briefly to such of these bonds as are in fairly general use, with special reference to those which seem to involve some considerable chance of loss and to those on which collateral security is necessary. Each form of bond has been given a catalogue number by the Treasury Department; and in order to identify the bond under discussion, the catalogue number will be referred to.

In this connection, it is to be borne in mind that if any person, knowingly and wilfully, with intent to defraud the revenue of the United States, smuggles or clandestinely introduces into the United States any goods, wares, or merchandise subject to duty by law and which should have been invoiced, without paying or accounting for the duty; or makes out, passes or attempts to pass through the custom house any false, forged or fraudulent invoice, every such person, his, her or their aiders and abettors will be deemed guilty of a misdemeanor, and on conviction, will be fined in any sum not exceeding five thousand dollars or imprisoned for a term not exceeding two years. (R. S. Sec. 2865.) Any act resulting in a serious breach of a custom house bond would likely come within the scope of this law, and would therefore be punishable by imprisonment. The fear of punishment is always a great deterrent, especially when it is to be meted out by the Federal authorities.

Sec. 184.—**Warehousing Bond.** Cat. No. 3577 and 3577a. An important and much used class of custom-house bonds are those required to be given in connection with the storage of imported merchandise in bonded warehouses. When a man imports merchandise, which he does not desire immediately to dispose of, he is permitted to put it in a public store or a bonded warehouse, and is relieved of the payment of duty until the merchandise is withdrawn; provided, however, that it must be withdrawn, and the duty paid, within three years. Every importer, who thus puts imported goods in public store or bonded warehouse, is required to give bond conditioned "that within three years from the date of original importation, the merchandise shall be regularly and lawfully withdrawn from public store or bonded warehouse, on payment of the legal duties and charges to which they shall then be subject; or, that at any time within three years from date of original importation, they shall be so withdrawn for actual exportation beyond the limits of the United States." As long as the merchandise remains in the warehouse, it may be sold for the payment of duty; and therefore there is no chance of loss as long as the merchandise will sell for enough to pay the duty. The only danger is that before the goods are withdrawn from the warehouse, the market may depreciate, or the goods deteriorate, to such an extent that they will not bring the amount of the duty, and the surety may be compelled to pay a duty which is greater than he can get for the goods. The thing to be considered therefore is the probability that the market for the goods will go down, or that the goods will

deteriorate to such an extent that they will not sell for enough to pay the duty. If therefore the merchandise is of a perishable nature, or if it will retain its value only for a season (such for example as Christmas goods imported especially for the holiday season), there may be some risk on the bond; and if the amount involved is large, the bond should not be issued unless the applicant is engaged in a well established business and is given a satisfactory rating by the mercantile agencies. However if the goods should so depreciate in value that they are not worth the duty, the owner can enter them for export and throw them overboard (R. S. Sec. 3052) and thereby relieve himself of the payment of duty. If the surety will see that this is done, the maximum liability will be the cost of getting the goods out of the country. And in order that the death or incapacity of the principal may not deprive the surety of this right, it is suggested that, in questionable cases and where the amount involved is large, a power of attorney authorizing the surety's representative to make the withdrawal be required.

In case of the actual injury to or destruction of any merchandise by accidental fire or other casualty, while it remains in the custody of the officers of the customs in any public or private warehouse under bond, the Secretary of the Treasury is authorized to abate the amount of import duties accruing thereon, so that no danger need be anticipated from this source.

Sec. 185.—**Bond for Warehouse.** Warehouses in which imported merchandise may be stored pending the payment of duty, as mentioned in the preceding

section, are, under the regulations of the Treasury Department, divided into eight classes, as follows:

Class 1. Stores owned or leased by the United States Government.

Class 2. Private warehouses occupied exclusively for storage of merchandise owned by the proprietor and entered in bond.

Class 3. Warehouses in occupancy of persons engaged in the business of storing dutiable merchandise for hire, and used for the general storage of dutiable merchandise and of unclaimed and seized goods.

Class 4. Yards, stables, sheds and stores, which are used exclusively for the storage of animals, wool, coal, lumber, molasses, sugar, iron and other articles, when specifically authorized.

Class 5. Bins or parts of buildings used for the storage of imported grain.

Class 6. Warehouses for the manufacture of imported merchandise intended for exportation, as provided for by the tariff act of July 24, 1897, Ch. 11 and the act of Aug. 5, 1909, Ch. 6, S. 23.

Class 7. Warehouse for smelting and refining.

Class 8. Warehouse for smelting and refining of imported lead-bearing ores or base bullion, under Section 24 of the tariff act of Aug. 5, 1909.

The Government places a customs officer, known as a storekeeper, in charge of each of these warehouses; and it his duty to carry the keys to the warehouse, open it in the morning, close it in the evening and see to it that no merchandise is withdrawn except upon the permit of the collector.

And the Government requires the owner of each warehouse (except of course those of class 1) to give bond conditioned substantially that he will in all respects comply with the provisions and requirements of the warehousing laws and the regulations of the Treasury Department relating thereto, and exonerate and hold the United States and its officers harmless from or on account of any risk, loss or expense, of any kind or description, connected with or arising from the deposit or keeping or transferring of imported merchandise, including the expense of any kind or description incident thereto, or caused by the transfer of merchandise from the warehouse or premises on the discontinuance thereof as a bonded warehouse; and will also pay to the collector, monthly, the salary of the customs officer in charge of said goods, wares and merchandise; and will promptly report to the collector any and all damaged or perishable articles that may be found in said warehouse; and will not receive any gunpowder or other dangerous or explosive substances (except fire crackers) in said warehouse; and will keep in repair said warehouse; and will not remove, nor suffer to be removed, any goods, wares, or merchandise from the warehouse without lawful permit and without the presence of the customs officer in charge. The language

of the bond differs slightly in the different cases, but uniformly it contains the provision that the principal shall not remove nor suffer to be removed any goods, wares, or merchandise, from the warehouse without lawful permit and without the presence of the customs officer; and that is the main purpose of the bond, the other obligations being incidental and not at all likely to involve a loss to the surety. And there is practically no probability that he will permit any of the merchandise to get out of the warehouse without a lawful permit; for in the first place, the customs officer has complete charge of the warehouse, and no entry can be made without his consent, and he is a bonded government official who may be expected to perform his duties. In the second place, a penalty of fine and imprisonment is provided by law in case any importer or proprietor of a bonded warehouse, fraudulently or by any contrivance, opens or gains access to the warehouse except in the presence of the proper officer of customs (R. S. 2986), or, in case any warehoused merchandise shall be fraudulently concealed in or removed from any warehouse (R. S. 2987). And in the third place, the principal generally has considerable financial strength. The warehouse itself, is generally of quite considerable value, although, of course, it is often mortgaged. However, the equity is usually sufficient to keep the owner straight. In the case of private bonded warehouses, whether used for storage only or for manufacturing, the owners are often concerns of very considerable financial strength and standing.

These bonds, though continuous, are, as a class, de-

sirable business. The insolvency of the principal would not necessarily, or even likely, impose any loss on the surety, for the receiver would be required to fulfil the obligations under the bond, and no merchandise could be withdrawn except in the presence of the storekeeper. While it is always well, if possible, to avoid becoming surety for concerns which are likely to become insolvent, yet I believe a surety company would be safe in executing these bonds for practically all applicants.

Sec. 186.—**Bond for Storage of Imported Tea.** Cat. No. 3891. A slight variation from the usual warehouse bond is required in connection with the importation of tea. Under an Act of Congress of March 2, 1897, entitled an "Act to Prevent the Importation of Impure Tea," all tea that is brought into this country must be inspected and passed by United States inspectors before it will be delivered to the importer for sale or consumption. And nearly all tea importers maintain private warehouses for the storage of imported tea; and, pending the examination, they are permitted, by regulation, to remove the tea to their warehouses, provided they shall first have given bond conditioned that no such tea shall be removed or delivered from the warehouse except in pursuance of the collector's permit for the release of tea which has been examined by the United States officers, under the Act aforesaid.

The collector of customs does not put a storekeeper in charge of tea warehouses, and it is therefore physically possible for the importer to remove the tea without waiting for the inspection. In practice however, this is very seldom if ever done, because, in the first place,

it does not cost anything to permit the inspection, and therefore there is no incentive for an honest importer to attempt to evade the law; and, in the second place, tea importers, who maintain private warehouses, are generally men of financial responsibility who cannot afford to be dishonest by attempting to import impure tea.

In view of the fact that the Government does not keep a storekeeper at these warehouses, some companies regard these bonds as involving considerable risk, and direct that they be issued only for concerns having adequate financial responsibility. In practice, applicants for these bonds do have financial responsibility, and so far as I am aware, no one has ever heard of a loss under a bond of this kind. Therefore, I think they can safely be executed for practically all applicants. As a rule, the customs officers are prompt in making the examination of the tea, so that liability under the bond generally terminates within thirty or at most sixty days.

Sec. 187.—**Bond for Exportation of Impure and Unwholesome Tea.** Cat. No. 3893. We have seen that tea cannot be brought into this country, unless it is examined and approved by United States inspectors, under an Act of Congress of March 2d, 1897, entitled "An Act to Prevent the Importation of Impure and Unwholesome Tea."[1] When tea is rejected, as being within the prohibitions of that act, the owner is required to give a bond conditioned that the tea shall be exported without the limits of the United States, within six months, and that evidence shall be produced to show

[1]See Preceding Section.

the landing abroad of the merchandise and that all custom-house charges, which may attach prior to the exportation, shall be paid.

In such cases, the importer generally has no alternative but to export the tea; for the customs officials keep supervision over it, so that he probably could not dispose of it in this country if he should desire to do so; and the customs officers, of course, would not permit him to enter it for export without paying the custom-house charges. Hence there is very little risk and these bonds may be executed for practically all applicants. Liability terminates within six months.

Sec. 188.—**Transportation Bond.** Cat. No. 3765. When imported merchandise is stored in a bonded warehouse, the owner may, during the three year period allowed for the payment of duty,[1] desire to take it to another port, and may still want to defer the payment of duty. The regulations of the Treasury Department permit this to be done, provided the merchandise be transported "in bond." In order that merchandise may be thus transported, it is necessary that it be transported by a carrier that has been regularly designated as a "common carrier for the transportation of merchandise in bond;" and that the owner give a bond conditioned that, within a specified time, he will transport the merchandise, or cause it to be transported, by such a carrier, and that he will deliver it to the collector at the port of destination, and that due entry thereof will be made for re-warehousing, and that he will, within a time speci-

[1]See Section 184.

fied, produce to the collector at the port of withdrawal, the certificate of the collector at the port of destination, that the merchandise has been delivered to him according to law and re-warehoused or the duties thereon paid; or failing to do so, will pay to the proper collecting officer of the United States, at the port of withdrawal, the amount of duties and an additional duty of one hundred per cent.

When the merchandise is once delivered to the carrier, the responsibility of the owner practically ceases; for his responsibility then becomes secondary to that of the carrier. The risk the surety on the bond of the owner takes is mainly that the principal will not deliver the merchandise to the carrier, but will otherwise dispose of it in order to avoid the payment of duty. However the merchandise, while being transported from the warehouse to the vessel or cars, is under the supervision of a customs officer, so there is little chance for the principal to divert the merchandise. And inasmuch as any liability would accrue almost immediately upon the execution of the bond, the surety does not have to run the risk of a serious change in the financial condition of the principal; and that is the real hazard involved in bonds where the accrual of liability is deferred. Looking at the matter from a practical point of view, it may be said that almost anybody who is engaged in a legitimate business may be depended upon to comply with the condition of such bond, and they may be executed for all applicants. Bonds of this kind may be cancelled at the end of thirty days.

Sec. 189.—**Bond for Transportation and Exportation.** Cat. No. 3837.[1] In many cases, merchandise, which is destined for some point in Canada or Mexico, is landed at one of the ports in the United States, and is carried to its ultimate destination either by rail or by a coast steamer. In that event, the payment of duty is of course not demanded, but the owner is required to give a bond conditioned that, within a specified time, the merchandise will be transported by a certain ship or railroad company (which must have been designated as a common carrier for the transportation of merchandise in bond) and exported to a foreign city; and that, within the same time, the proofs required by law that the said condition has been performed will be deposited with the collector. The risk on this bond is no greater than on a transportation bond.[2]

Sec. 190.—**Bond of Carrier for the Transportation of Merchandise in Bond.** Cat. No. 3573. In order to obtain the right to transport merchandise "in bond," a carrier, whether a railroad or a steamship company, must secure a designation from the Treasury Department and give bond in the sum of one hundred thousand dollars, conditioned that it will "duly observe and faithfully comply with the laws of the United States and the regulations of the Treasury Department made in pursuance thereof, pertaining to the transportation and safe delivery of merchandise under sections 3000-1-5-6 of the Revised Statutes and the Act of June 10, 1880,

1A similar bond is that required for transportation and exportation of manufactured tobacco, (Cat. No. 3935) and that for the exportation of distilled spirits (No. 4525.)

2See preceding Section.

and all acts relating thereto; and shall pay the necessary expenses of such locks, seals and other fastenings as may be prescribed by the Secretary of the Treasury for securing the custody and safe transportation of such merchandise in such cars, vessels and vehicles, safes, trunks, or pouches as may be authorized and used by them for that purpose; and shall also pay the expenses of such inspectors as the Secretary of the Treasury, at his discretion, may cause to be stationed at points along the routes, or upon any car, vessel or other vehicle (such expenses to include the salary as well as the actual necessary traveling expenses of such inspectors) in such manner as may be directed by the Secretary of the Treasury; and shall without delay, transport and make prompt report, by delivery of the manifest which shall accompany the merchandise, and make safe delivery of all merchandise, as described on each and every entry or manifest and in each receipt therefor executed by the carrier or its duly authorized agents, delivered to said carrier for transportation under the provisions of the aforesaid laws, or any of them, to the collector or other proper officer of the customs, to whom the merchandise is consigned in the manifest, in the manner required by law and the regulations aforesaid; or, in default of such transportation report and delivery, shall pay to the United States, as liquidated damages, an amount equal to the value of the dutiable merchandise not so transported, reported and delivered, except where delivery shall have been made to the ultimate consignee or owner, instead of to the collector or other proper officer of the customs, in which case, an amount

equal to twice the duties, together with all costs, charges and expenses caused by the failure to make such transportation report and delivery, and shall also protect and save harmless the United States from any loss or damage resulting from fraud or negligence on the part of any officer, agent or other person employed by the carrier."

The language of this bond has been quoted at length as the briefest and best statement of the liability and risk of the surety. The essence of the obligation is that the carrier will safely transport the merchandise and deliver it to the collector of customs, who is named as consignee in the manifest. If the carrier is a railroad, the merchandise is required to be carried in "bonded cars;" that is, cars in which only merchandise in bond is carried, and which are sealed and generally locked by a customs officer at the point of origin and which can legally be opened only by a customs officer at the point of destination. So also if the merchandise is carried in a vessel, it is sealed by a customs officer, the cost of the locks and seals being paid by the carrier. The collector often assigns inspectors along the route of railroads and on board vessels carrying bonded merchandise; and the salary and expenses of such inspectors are to be paid by the carriers. These expenses do not amount to much; and it is improbable that a reputable carrier will deliberately divert the merchandise from the consignee (the collector of customs), and deliver it to the owner or other person. And it is provided by law that in case of an actual injury to, or destruction of, any merchandise by accidental fire or

other casualty while in transportation under bond, the Secretary of the Treasury has the right to abate the duty. (R. S. Sec. 2984.) The principal danger seems to be from an accidental loss not within the scope of this section, or a loss from negligence on the part of the employees of the carrier. The chance of loss by the surety does not seem therefore to be very great; and the only requirement is that the carrier shall be in good standing and in a reasonably good financial condition. This bond is continuous, needing no renewal.

Sec. 191.—**Bond for Cartmen, Draymen and Lighterman.** Cat. No. 3855. We have seen that in order for railroad and steamship companies to obtain the right to transport merchandise in bond from one city to another, they must be specially authorized by the Secretary of the Treasury so to do and must give bond. Likewise the regulations of the Department forbid that merchandise in bond be carried from one warehouse to another, or to any other place, except by draymen or lightermen who have been licensed as such and who have given bond conditioned to perform their duties acording to the rules and regulations of the Treasury Department relative to the lighterage, cartage or drayage of goods in bond, and to make good all loss or damage that may happen in the handling of any goods from vessels to bonded warehouses or to public stores or from one warehouse to another or to any other place.

The obligation of conforming to the rules and regulations of the Treasury Department is not likely to result in any loss under the bond. The principal danger is either that some of the packages will be lost

in transit or that the drivers will take some of them. However this risk has not been found to be very great, and any cartman or cartage company, in good standing and fair average financial condition, would be entitled to this bond. If possible, it should be arranged that the drays for the carriage of small packages be properly screened so as to prevent a theft or an accidental loss of any of the packages in transit. Where the applicant is an importer, who will handle only his own importations, there is practically no risk on the bond; and in that case, the bond may be issued without question.

A licensed cartman is to be distinguished from the man who enters into a contract with the Government, at specified rates, for the cartage of merchandise in the custody of the Government, under Act of June 22, 1874, Chapter 391, Section 25. The bond of such a contractor covers all the liability of a licensed cartman, and in addition, obligates the principal to do the draying at the specified rates, whether it is profitable or not. The desirability of such a bond should be tested by the principles governing applications for contract bonds.

Sec. 192.—**Bond for redelivery.** Cat. No. 3775. We come now to a class of bonds on which there is great danger of loss and where the surety should be fully protected by collateral security. The law permits certain articles to be brought into this country free of duty, when they are to be used here only temporarily and for purpose of exhibition. In order that the payment of duty may thus be avoided, the owner is re-

quired to give bond conditioned that he will, within six months, redeliver the article to the collector of customs at the port of its importation and furnish such proof of its identity as the Secretary of the Treasury, by regulation, may require, and enter the articles for exportation from the United States, within the said six months. Although the bond, by its terms, provides that the article shall be delivered to the collector at the port of its importation, it is now permissible to export the article from any port in the United States. See Treasury Decision 31999.

This situation affords the importer almost unlimited opportunity to dispose of or secrete the article and refrain from either paying the duty or exporting the article; and, inasmuch as the importers of such articles are generally foreigners, who have no other property in this country, collateral security to the full amount of the bond should be required; and the collateral should not be returned until the surety is furnished with a certificate of the collector that the article has been entered for export and actually exported.[1]

Sec. 193.—**Bond on Importation of Certain Animals for Exhibition.** Cat. No. 3779. A similar bond is necessary in the case of the importation, free of duty, of those animals on which no duty is required to be paid if they are to be used merely for purpose of exhibition. The bond is conditioned that the importer will, within six months from the date of original importation, actually export the animals beyond the

[1]These bonds are generally known as theatrical exhibit bonds.

limits of the United States and file with the collector the evidence, required by the customs regulations, of such exportation, within ninety days thereafter.

This law is availed of principally by Canadians who exhibit their live-stock at our agricultural fairs, although it is also taken advantage of by those who desire to exhibit dogs and other animals on the stage.[1] It affords an excellent opportunity to bring into this country, without paying duty, animals which are not in fact intended merely for exhibition; and inasmuch as there is an unlimited opportunity to dispose of the animals without paying duty, and inasmuch as such exhibitors usually have little or no available financial resources in this country, collateral security should be required. In the case of large exhibitions at our agricultural fairs, a customs officer is usually assigned to watch the exhibit while it is here, and if any animals should be sold, (as is often the case) the officer, as well as the purchaser, will likely see that the duty is paid. If it is not, the Collector of Customs, being informed by the officer, would, no doubt, confiscate at least enough of the remaining animals to pay the duty. In such cases, the risk is not as great as when the importer is left to follow his own inclination. However, inasmuch as the principal in such a bond is likely to be a foreigner, from whom it would be difficult to collect any amount the surety might be called on to pay, it would probably be well not to issue these bonds without collateral even where supervision will be exercised

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[1]These bonds are commonly known as theatrical exhibit bonds.

by the customs officers, as such supervision will not necessarily prevent the importer from disposing of the stock and declining to pay the duty. Liability on the bond terminates within nine months from its date.

Sec. 194.—**Bond for Exhibition of Works of Art.** Cat. No. 3777. The tariff act of August 15, 1909, paragraph 715, provides that works of art, when they are intended for exhibition and not for sale, may be imported free of duty by any State, or by any society or institution established for the encouragement of the arts, science or education; or by any society or association or for a municipal corporation for the purpose of erecting a public monument. In all such cases, the importer is required to give a bond conditioned that he will not sell, expose for sale or use any of the articles contrary to law and the provisions of the customs regulations adopted in pursuance thereof.

The chance of loss under this bond is that the name of some such society or institution will be used as a cloak to enable a speculator to bring in free of duty articles which are intended for sale and not merely for exhibition. The collector of customs would look very carefully to see that the society or institution was not fictitious, that it was in possession of a proper place for the permanent exhibition of the articles and that the individuals who desire to make the importation are connected in a proper official capacity with the institution. And furthermore, in case of articles of any considerable value, the collector would retain supervision over them until they were permanently located. The actual chance of loss would therefore seem to be

small. However this bond is of unlimited duration, for if the articles should be sold at *any time* in the future, there would be a breach of the bond. It is doubtful, however, if the customs officers would attempt to trace the articles, although they are at all times, subject to examination by the proper officers of customs. The practice with regard to importations under the act is too limited to admit of anything like a definite statement as to the chance of loss, and it is suggested that considerable care be exercised and that collateral be waived only in very clear cases.[1]

Sec. 195.—**Lay Order Permit Bond or Bond for the Loading and Unloading of Vessels at Night.** In a proper case the collector of customs will, upon the arrival in port of a vessel belonging to a line designated as a common carrier for the transportation of merchandise in bond, issue a permit for the immediate loading of the vessel, and will grant a special license to load and unload at night. In order to obtain such a license, it is necessary, among other things, that a bond be given, the condition of which is that the principal shall indemnify the United States and the collector from all losses and liabilities which may occur by reason of the granting of the license; and shall pay to the collector promptly a sum sufficient to reimburse the Government for the services of the inspector or other customs officers and employees in connection with the loading or unloading of the vessel at night, on Sundays

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[1]This bond will probably become obsolete, or nearly so, under the new tariff act of 1913, which puts practically all works of art on the free list.

or holidays. (R. S. Sec. 2871 and Act Feby. 13, 1911, Ch. 46, Sec. 6.)

This bond may, like many other custom-house bonds, be given for a period of six months; that is, to cover the loading and unloading of all vessels that may be consigned to the principal during that period. And, under the Act of February 13th, 1911, it is not necessary for each particular steamship company to give the bond. One bond may be given to apply to all vessels consigned to the principal or for which the principal shall act as owner, agent or consignee,—thus enabling steamship agents to give one bond for all lines represented.

It is difficult to see how any loss or liability could be incurred by the United States or the collector by reason of the granting of the license; and such liability has seldom, if ever, occurred. The matter of paying for the services of the inspector, in connection with the loading or unloading at night and on Sundays and holidays, is a small expense which, it is believed, has uniformly been paid without resort to the surety, as it accrues at once. It has been the custom to issue this bond for any regular transportation line; and since there is no record of a loss under one of these bonds, there would seem to be no objection to issuing them in the name of the agent, although it would be well enough to look up the matter of the authority of the agent to represent the lines mentioned in the bond.

Sec. 196.—**Bond for Redelivery of Unexamined Packages under Section 2899 of the Revised Statutes or the Act of June 30, 1906, or Both.** Cat. Nos. 3385,

3389, 3393. When there is an importation of any considerable number of packages of the same kind, which come within the scope of the Pure Food Law (Act June 30, 1906) or of Section 2899 of the Revised Statutes of the United States, or both, and are therefore to be examined and appraised by the customs appraisers, the Collector usually designates some of the packages for appraisement, and permits the importer to remove the others. He will however require the importer to give a bond conditioned that he will redeliver the packages, upon demand, within ten days after the packages so designated for examination shall have been appraised and reported to the Collector, and also that, in the meantime, none of the packages delivered as aforesaid shall be opened without the written consent of the collector or surveyor, and then, in the presence of an inspector of customs.

If the appraisers find the packages which they examine to be different from what they expected to find, they may require that the other packages be redelivered for examination. In practice, the collector permits only importers of good standing, and whose goods are well known, to remove any of them without previous examination and appraisement; and the result is that seldom, if ever, does the collector find it necessary to recall packages that have been delivered. The demand for redelivery must be made, if at all, within ten days, so that liability terminates at the end of that period. Such bonds are commonly known as "ten day bonds;" and a separate bond may be given for each importation, or one bond may be given to cover all

importations during a period of six months. (Cat. Nos. 3387, 3391, 3395.) These bonds may be issued for all applicants.

Sec. 197.—**Bond on Export of Imported Merchandise with Benefit of Drawback.** Cat. No. 4483. When merchandise is imported into this country and then exported, whether in the same form or in a form to which it has been changed by a process of manufacture, the duty that was paid on its importation will be refunded, provided the merchandise has never left the custody of the customs officers, and provided certain other conditions are complied with. The owner must however give a bond conditioned that the merchandise shall not be re-landed in any port or place within the limits of the United States and that the certificates and other proofs required by law, of the delivery of the same at a place without the limits of the United States, shall be produced within a specified time. The most usual case that comes within the scope of this regulation is when raw materials are imported, placed in a bonded warehouse, and there manufactured into a finished product and exported,—such exportation being known as exportation with benefit of drawback, that is, with the right to obtain a refund of the duty.

The risk under this bond is that the principal will take the merchandise to another port and enter it free of duty, on the ground that it is of American manufacture. But the warehouse is in charge of a Government storekeeper, who keeps close supervision over the goods, so it is hardly possible for the principal to violate the condition of this bond. Furthermore, it is

hardly reasonable to suppose that a man who is regularly engaged in a manufacturing business, with capital invested, would be likely thus to try to evade the payment of duty when he knows that he will certainly be discovered at the end of the time within which he is under obligation to produce the documents showing the landing of the merchandise abroad, and be compelled to pay the duty and suffer the penalty of imprisonment provided by law. (R. S. Sec. 3049.)

These bonds may be discharged only by producing within the year, if the exportation is made to Europe or America, or within two years, if made to any part of Asia or Africa, a certificate of the consignee at the port of destination particularly describing the articles so exported and their actual contents and declaring the name of the vessel from which the same were received; and where the merchandise is consigned to a person on board the vessel, a certificate from the person to whom the merchandise may be sold and delivered may be produced with the same effect as the certificate of the consignee at the port of destination. (R. S. Sec. 3044.)

In addition to such certificate, it is necessary to produce a certificate of the American Consul at the port of destination declaring that the certificate of the consignee is true to his knowledge or that it is deserving of full faith and credit. It is also necessary that the certificate of the consignee and the consul be confirmed by the oath of the master and mate or other persons named in the statute. (R. S. Sec. 3045.)

The production of these certificates is not a matter

that should concern the surety. If in fact the merchandise was landed at the foreign port, it is not generally difficult to satisfy the Treasury Department, although there may be a technical defect in the certificates. Accordingly, this bond may be issued for all applicants who are engaged in business and are in good standing.

Sec. 198.—**Bond for Examination and Appraisement of Machinery at Place of Delivery or Destination.** Cat. No. 3401. In cases where very large and cumbersome machinery is imported, the collector of customs, instead of having it sent to the appraiser's store to be appraised, may permit it to be sent directly to the factory or plant where it is to be used; and, after it is set up there, the appraisers will go there and appraise it. In such cases, the importer is required to give a bond conditioned that the machinery shall be promptly set up at the place of delivery or destination, at the risk and expense of the principal, and that due notice thereof be given in writing to the collector within ninety days in order that examination and appraisement of the same may be completed, and that the principal shall pay to the United States all duties and charges that may be found due on said machinery, including expenses incurred by the person or persons designated to examine and appraise the same, and that he shall accept the examination and appraisement as in all respects binding and valid. (Cat. No. 3401.) There is little risk on this bond because such machinery cannot well be secreted or disposed of, so that the lien of the United States for the duty could under almost any circumstances be enforced, without resort to the bond.

The Collector of Customs is prompt in making demand for payment and there is little or no chance that the owner will have much opportunity, or will attempt, to evade it; and if he should become incapacitated or unable to pay, the machinery could likely be sold for enough to pay the duty. This bond may likewise be issued for all applicants who are in business and in good standing.

Sec. 199.—**Miscellaneous Custom-House Bonds.** While we have considered the bonds most frequently needed in connection with the importation of merchandise, as well as those on which collateral security is necessary, yet I have not, by any means, mentioned all the different kinds of bonds that may be required in this connection. For example, the regulations of the Treasury Department require that when dutiable merchandise is sent to this country, the invoice must be certified in triplicate by the United States Consul nearest the port from which the merchandise is sent, and that the Consul must send a certified copy to the collector of customs at the port to which the merchandise is destined. And whenever, from a change of the destination of the merchandise after the production of the invoice to the consul, or from other cause, the authenticated invoice is not received by the collector at the port where the merchandise actually arrives, the collector may nevertheles permit the consignee to make entry of the merchandise upon paying duty on the basis of an appraised value fixed by the customs' appraisers, and giving bond conditioned that he will "within six months, produce to the collector of customs a duly au-

thenticated invoice of the goods, and pay to the collector the amount of duty to which it shall appear, by such invoice, the goods are subject over and above the amount of duties estimated on the appraisement of said goods.'' (Cat. No. 3379a.)[1] So there is the bond to produce a certificate of exportation of American products, (Cat. No. 3397) to produce a certain declaration of the foreign exporter of domestic products, (Cat. No. 3399) to produce a certain declaration of the absent owner of imported merchandise, (Cat. No. 3383) to produce certificate of origin of merchandise from the Philippine Islands, and other similar bonds to produce documents (Cat. No. 3375).

Now the purpose of producing such documents is to determine whether or not the merchandise is dutiable or whether the proper amount of duty has been paid. In practice the customs officers rarely let an article get by unless the proper duty has in fact been paid, so that the bond is a mere form, which, however, must be given in compliance with law and regulations. The production of the document is ordinarily only a matter of detail, and if it should be difficult or impossible, by reason of death or otherwise, the Treasury Department will generally waive its production.

There is another large class of bonds required upon the entry of merchandise, or upon its withdrawal from bond for a special purpose which admits, free of duty, merchandise ordinarily dutiable. There is the bond for the withdrawal of salt for curing fish (Cat. No. 3743);

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[1]This bond practically takes the place of Cat. Nos. 3379 and 3381.

for the withdrawal of supplies, for a vessel clearing coastwise (cat. No. 3879); for the entry or withdrawal of materials for construction or repair of vessels or of their machinery under Section 5 of the Act August 24, 1912 (Cat. No. 3755). In all such cases the collector is well satisfied, before he permits the merchandise to be entered or withdrawn from bond, that it will in fact be used for the stated purpose, and makes very little or no subsequent investigation. Where the quantity is unusual or there is anything to excite suspicion, investigation is made in advance.

In general it may be said that with the exceptions noted, custom-house bonds involve very little or no actual risk and that they may be executed with considerable freedom,—practically for all applicants. Indeed, it is the very general policy of the companies to waive formal applications and sign these bonds upon the mere request of the importer or even of the custom house broker. And these bonds are needed so frequently, and the amount involved and the individual premiums so small that it hardly pays an agent to go to the Custom-House so often to sign the bonds, unless, of course, he is handling a large volume of the business. Accordingly some of the companies give to the custom-house broker or to the importer a power of attorney authorizing him to sign the bonds on behalf of the company. In practice this works out satisfactorily and enables a company to handle a line of business on which there are no losses, but which could not otherwise be profitably handled. It is of course unnecessary to add that some discretion must be used in selecting

the persons to whom such powers of attorney shall be issued.

In this connection it may be well to call attention to the fact that provision is constantly being made by the Treasury Department for new kinds of bonds, and to suggest that any such new bonds, or bonds not referred to in this chapter, be examined to see that they involve no particular hazard. The principal point is to look out for bonds which partake of the nature of "theatrical exhibit bonds," that is to say, which provide for redelivery to the collector of customs of merchandise which has been turned over to the importer, free from the control of the officers of customs, and on which, if not so redelivered, an import duty is payable.[2]

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[2]See Sections 192-193.

CHAPTER XIII.

INDEMNITY TO SURETY.

Sec. 200.—**Scope.** In receiving application for bonds it will often happen that the applicant, as an inducement to the surety company to execute the bond, will offer, in addition to his own indemnity, the indemnity of a third person, firm or corporation; that is to say, will offer to have such third person, firm or corporation agree, by instrument in writing under seal, to indemnify the surety against loss, that is, to pay any sum for which the surety may become liable, including costs, expenses and counsel fees.

Sec. 201.—**The Unreliability of Personal Indemnity.** While the companies very frequently accept and indeed require personal indemnity, yet it has been found to be very unreliable, and very little faith or dependence ought to be put in it. One company reports that, in making a partial examination into the causes of its losses during the year 1912, it found that more than $37,000.00 was directly attributable to the acceptance of bonds on the faith of personal indemnity, which was thought to be good, but which turned out to be worthless or nearly so. The president of this company says "Indemnitors are still costly, and we pay dearly for accepting business otherwise objectionable relying on them." The objections to personal indemnity, and the things that make it unreliable, may be summarized as follows:

1. An indemnitor generally signs the agreement on the assumption that the principal will perform the obligation; and when trouble comes, the indemnitor is slow to live up to his obligation. He generally argues that the surety company was paid for taking the risk and that the surety company ought not to look to him, who received no compensation. He overlooks the fact that the surety company was not paid for taking any risk, but merely for the use of its name and credit, and that he stood sponsor for the principal, and that it was on the faith of his guarantee that the bond was written. It therefore seldom happens that indemnitors live strictly up to their obligations; and in many cases it is necessary for the surety company to advance the money and sue the indemnitor for reimbursement. This makes the business unprofitable, and furthermore it is quite probable that in such a suit the indemnitor will escape. Such a bond of indemnity, being given without compensation by an individual in favor of a compensated surety company, will, in accordance with the old rule for the construction of contracts of suretyship, be strictly construed in favor of the indemnitor, whereas the bond of the surety company will likely be construed liberally in favor of the obligee, so that the surety company may be held liable while the indemnitor escapes.

2. The indemnitor may die and his estate be distributed to his heirs, or he may move to parts unknown before liability accrues.

3. When liability acrues the indemnitor may be

insolvent or unable to meet the obligation. This is a frequent occurrence.

4. The indemnitor is likely to learn, before the surety company, of the approach of trouble and dispose of his property and make himself ''execution proof.''

Sec. 202.—**When Bonds may be Issued on the Strength of Indemnity.** In view of the reliability of personal indemnity, it is manifest that very little dependance can be put in it; and the following rules are suggested for the guidance of underwriters, who are so often requested to issue bonds on personal indemnity.

1. A bad risk, that is a risk which is distinctly *below* the standard, should never be accepted on the strength of personal indemnity. In cases which are on the border line—where there is some doubt about the applicant's ability to perform the obligation guaranteed, or where it is impossible or inconvenient to get full information—the risk may sometimes be accepted on personal indemnity, where the indemnitors are found, upon a verification of their financial statements, to be worth in net available assets subject to execution, an amount equal to two or three times the amount of the bond.

2. Where the deficiency of the applicant is in financial resources—as where a contractor has not the necessary funds—the risk should not be accepted on the indemnity of third persons, unless such persons are able and have agreed, by loans or endorsements, to make up the deficiency.

3. Credit guarantees, or bonds directly guaranteeing the payment of money, should not in any event be accepted on the strength of personal indemnity, although of course there is no objection to the acceptance of personal indemnity in cases where the applicant seems to be strong enough financially to warrant the execution of the bond. No matter how strong the indemnitors may be, the chances are ten to one that the surety company will have to pay the money and look to the indemnitors for reimbursement; and that as we have seen, makes the business unprofitable, and involves considerable chance of loss.

4. Personal indemnity is particularly unreliable where the bond will continue in force for a considerable period of time; and it is suggested that where the obligation covers as much as two years, the bond should not be accepted on personal indemnity even though the bond may be on the border line. However, where it is deemed prudent regardless of indemnity, to accept such long-term guarantees without collateral, it is nevertheless always advisable to get as much indemnity as possible and from as many different persons as possible; for if the principal should fail, it may be that some one of the indemnitors will be alive and solvent at the end of the period. In such cases the personal indemnity should be taken only with caution and should not be made the excuse for the acceptance of a poor risk.

Sec. 203. **The Enforceability of Indemnity Bonds.** When the indemnity of a person, firm or corporation, other than the applicant, is offered, it is important, be-

fore executing the bond, to know that the indemnity is valid and enforceable, so that, if the indemnitors are solvent, recovery may be had. This is quite important, for there is grave doubt about the validity of much of the indemnity that is offered to surety companies.

In the first place, there is the perplexing question as to the validity of such a bond of indemnity when executed by a corporation, other than a surety company. It is the rule that a corporation can do only those things which are, either expressly or by necessary implication, authorized by its charter; and it is most unusual for an ordinary business corporation to be expressly authorized by its charter to become surety or guarantor for another; and it is hardly within the scope of any business to become surety for others. Applying strict legal principles, the conclusion would be inevitable that a bond of indemnity executed by such a corporation would be unenforceable. Such a strict application of legal principles would, of course, lead to many hardships and much fraud; and the courts of nearly all the States now apply, to some extent at least, what is known as the estoppel doctrine.[1] In applying this doctrine the courts almost universally hold that where the corporation has received the benefit of a contract which has been executed by the other party, it will be estopped, while retaining the benefits, to deny its corporate power to execute the contract; and

[1] This doctrine appears to be denied in Alabama (Chewala Lime Works vs. Dismukes, 87 Ala., 344.) and in Illinois, (Best Brewing Co. vs. Klassen, 185 Ill., 37.)

therefore, where the corporation, which offers to execute the bond of indemnity, will receive, or may be expected to receive, substantial financial benefits from the execution of the bond by the surety company, it is fair to assume that a bond of indemnity, executed by the corporation in consideration of the execution of the bond by the surety company would be held valid. It is, however, most important to recite in the bond of indemnity the facts showing the benefit to be derived by the corporation from the execution of the bond by the surety company. It is not enough to recite that the bond was executed at the request of the corporation, or that the corporation has "an interest" in the transaction; *facts* should be stated showing just what the interest of the corporation is and how it expects to be benefitted by the execution of the bond by the surety company.

The courts of some of the States have gone a step further and have held that where a contract, which is *ultra vires* as to one of the parties, has been performed by the other party, whether the first party has received any benefit therefrom or not, the first party will be estopped to deny its power to make the contract. The contract between the surety company and the indemnitor consists of a promise on the part of the surety company to execute a bond, in consideration of a promise on the part of the indemnitor to protect it from loss. When therefore, the surety company executes the bond, it performs its part of the contract; and where this rule is in force, the indemnitor corporation would be estopped

to deny its power to execute the bond of indemnity, whether it had received any benefit from the transaction or not. While the general doctrine has been announuced in nearly all the States, yet it has not often been applied in such a flagrant case as where the corporation has become an accommodation surety or guarantor for another; and it is by no means certain that this rule will universally be applied in those cases. As a rule it is not well to rely upon bonds of indemnity executed by corporations, unless the corporation will derive, or expects to derive, a substantial financial benefit from the execution of the bond by the surety company, and unless the facts showing that such benefit will be derived are recited in full in the bond of indemnity.

In the second place, a member of a co-partnership, on hehalf of the firm, will sometimes offer to give a bond of indemnity. Such a bond will bind the firm only when the giving of the bond is written the scope of the partnership business, and, as we have seen, it is hardly within the scope of any business to become surety or guarantor for others. If the execution of the bond by the surety company will advance the interests of the firm, along the lines of the business in which it is engaged, and may be expected to produce some financial reward for the firm, an indemnity bond executed on behalf of the firm, by one of the members, would perhaps be enforceable. But, as a general proposition, it is wise to rely upon the indemnity only of those members of the firm who actually execute the instrument.

In the third place, the indemnity of a married woman is often offered; and in about half the States, a married woman has no power to become surety or guarantor for another; and her indemnity would be unenforceable. The rule in each State on this subject is given in a note.[1]

The indemnity of all other persons, who are of age and of sound mind would ordinarily be valid.

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[1]ALABAMA.—Void as to bond on behalf of husband (Code 1907, Sec. 4497); and a mortgage given in connection with such a bond would be void. Osborne vs. Cooper, 113 Ala., 405. Valid as to bond on behalf of third person.

ARKANSAS—Void. Collins vs. Underwood, 33 Ark. 265.

CALIFORNIA—Valid as to separate property (Civil Code, Sec. 158), but not as to community property unless secured by pledge or mortgage thereof executed by the husband. Civil Code, Sec. 167; Goad vs. Moulton, 67 Cal., 536.

COLORADO—Valid. Colo. St. Anno., Sec. 4191.

DELAWARE—Valid. Warder vs. Stewart, 16 Del. (2 Marv.) 275; 36 Atl. 88.

DISTRICT OF COLUMBIA—Void. Code, Sec. 1155.

FLORIDA—Void, but a mortgage on her separate estate, if executed according to the law respecting conveyances by married women, would be valid. Code 1906, Sec. 2588; Prentiss vs. Paisley, 25 Fla., 927.

GEORGIA—Contract of Suretyship or mortgage to secure such a contract is void (Code, Sec. 3007); but she may, as an original undertaker, become liable for goods furnished to another from which she derives no benefit. Freeman vs. Cole, 86 Ga., 590; 12 S. E. 1064. Perhaps a bond will be construed the same as goods.

ILLINOIS—Valid. Rev. St. 1912, Ch, 68, Sec. 6, p. 1284.

INDIANA—Void. Burns Anno. St., Sec. 7855.

IOWA—Valid. Code 1897, Sec. 3164. Low vs. Anderson, 41 Iowa 476.

KANSAS—Valid. Harrington vs. Lowe. 73 Kan. 1.

KENTUCKY—Void. Carroll's Statutes, 1909, Sec. 2127.

LOUISANA—Void as to obligation on behalf of husband, but probably valid as to an obligation on behalf of a third person, if executed with consent of her busband or the judge. Same rule as to a mortgage of her separate property. Hollingsworth vs. Spanier, 32 La. Ann. 203; Berwick vs. Frere, 49 La. Ann. 201.

MAINE—Valid. Mayo vs. Hutchinson, 57 Me., 546.

MARYLAND—Valid. Code, Art. 45, Sec. 5.

MASSACHUSETTS—Valid. Rev. Laws, 1902, Ch. 158, Sec. 2., Comm. vs. Abbott, 168 Mass., 471. Burney vs. Bank, 150, Mass. 574. Major vs. Holmes, 124 Mass. 108.

MICHIGAN—Void. Russell vs. Bank 39 Mich. 671; Fisk vs. Mills, 104 Mich. 433.

MINNESOTA—Valid. Rev. Laws 1905, Sec. 3607; N. W. Ins. Co. vs. Allis. 23 Minn. 337. King vs. Hansing, 93 N. W. 307 (Minn).

MISSISSIPPI—Valid. Code 1906, Sec. 2517.

MISSOURI—Valid. Rev. St. 1909, Sec. 8304. Grandy vs. Campbell, 78 Mo. App. 502; McCullum vs. Broughton 132 Mo. 601.

Sec. 204.—**The Preparation and Execution of Bonds of Indemnity.** It may not be out of place here to call attention to the importance of the proper preparation and execution of such bonds of indemnity. A slight error may render the bond void, as they are generally construed by the courts with great strictness.

NEBRASKA—Mortgage on separate real estate valid. Watts vs. Gantt, 42 Nebr., 869; Holmes vs. Hull, 50 Neb., 656. Indemnity bond would be void unless it appeared by some express words or act that she intended to bind her separate estate. Grand vs. Wright 53 Nebr., 574.

NEW HAMPSHIRE—Void as to bond on behalf of husband or a firm in which he is a partner. So also a mortgage on her separate real estate would be void. Stokell vs. Kimball, 59 N. H., 13; Buss vs. Woodward, 60 N. H. 58; Storrs vs. Wingate, 67 N. H., 190. Valid as to bonds on behalf of other persons. Parsons vs. McLane 64 N. H., 478.

NEW JERSEY—Void. Comp. Laws, 1910, p. 3226, Sec. 5. Mortgage on her separate property probably valid. Lomerson vs. Johnston, 44 N. J. Eq., 93.

NEW YORK—Valid. Bowery Nat. Bank vs. Sniffen, 7 N. Y. Supp. 520.

NORTH CAROLINA—Valid as to separate personal property, if husband joins in and if it is made an express charge against her separate estate; void as to separate real estate unless her privy examination is taken. Thompson vs. Smith, 106 N. C. 357; Jones vs. Craigniles, 114 N. C. 613.

NORTH DAKOTA—Valid. Rec. Codes 1899 Sec. 2767.

OHIO—Valid. Page & Adams Code, Sec. 7999.

OREGON—Valid. Lord's Oregon Laws, Secs. 7049-50; First Nat. Bk. vs. Leonard, 36 Oregon, 390; 59 Pac. 873.

PENNSYLVANIA—Void P. L., 1893, p. 344, Sec. 2; Purdon's Digest (13th Ed.) p. 2451; but a mortgage on her separate property would be valid. Kuhn vs. Ogilvie, 178 Pa. St. 303.

RHODE ISLAND—Valid. General Laws, 1909, Ch. 246, Sec. 3, p. 855.

SOUTH CAROLINA—Valid. Code 1912, Sec. 3761 and notes.

SOUTH DAKOTA—Valid. Civil Code 1913, Sec. 98. Colonial Mortgage Co. vs. Bradley, 4 S. Dak., 158; 55 N. W. 1108.

TEXAS—Void. Cruger vs. McCracken, 87 Tex. 584; 30 S. W. 537.

VERMONT—Void as to bond on behalf of her husband, although a mortgage, joined in by her husband, would be valid. Indemnity or mortgage valid when given on a bond in behalf of a third person. Pub. St. 1906, Sec. 3039., Reed vs Newcomb, 59 Vt. 630; 10 Atl. 593.

VIRGINIA—Valid. Pollard's Code of 1904, Sec. 2286a. Young vs. Hart, 101 Va. 480; 44 S. E. 703.

WASHINGTON—Valid. Kittitas vs. Travers, 16 Wash., 528; 48 Pac. 340.

WEST VIRGINIA—Valid as to the wife's separate personal property but not her real estate. Code 1913, Sec. 3680; Dages vs. Lee, 20 W. V., 584; Camden vs. Hiteshaw, 24 W. Va. 236. Mortgage on real estate, if properly executed, is valid. Code 1913, Sec. 3671.

WISCONSIN—Void. Disabilities of the Common Law not removed.

WYOMING—Valid. Comp. St. 1910, Sec. 3909.

Each company has its own printed forms; and the essential thing is that they shall be properly filled out and executed.

First, the names of all indemnitors should be inserted in the body of the bond, and at least one given name (and not merely the initials) of each indemnitor should be used.

Second, the bond of the surety company, on account of which the indemnity is given, should be accurately described; that is to say, the proper date, the correct name of the principal and of the obligee should be used. It is not so important to give a detailed description of the bond, as that what is given shall be accurate. If it is not, the courts may hold that the indemnity was not given on account of the bond in question; the effect of which would be to render the indemnity void. In my own experience I have had cases where liability was denied on account of very slight errors in the description of the bond; and in such cases, the result of a suit is always doubtful.

Third, the bond of indemnity should be signed by all the indemnitors; and they should sign their names just as they appear in the body of the bond; that is, with at least one given name and not merely initials.

Fourth, the signatures should be witnessed.

Fifth, the instrument should be acknowledged before a notary public or other proper officer.

The company above referred to as having made a partial examination into the cause of its losses during the year 1912, found that more than $10,000.00 was

attributable to the "acceptance of faulty or deficient indemnity agreements or neglect to complete offered indemnity." It will be seen therefore that this phase of indemnity agreements cannot with safety be overlooked.

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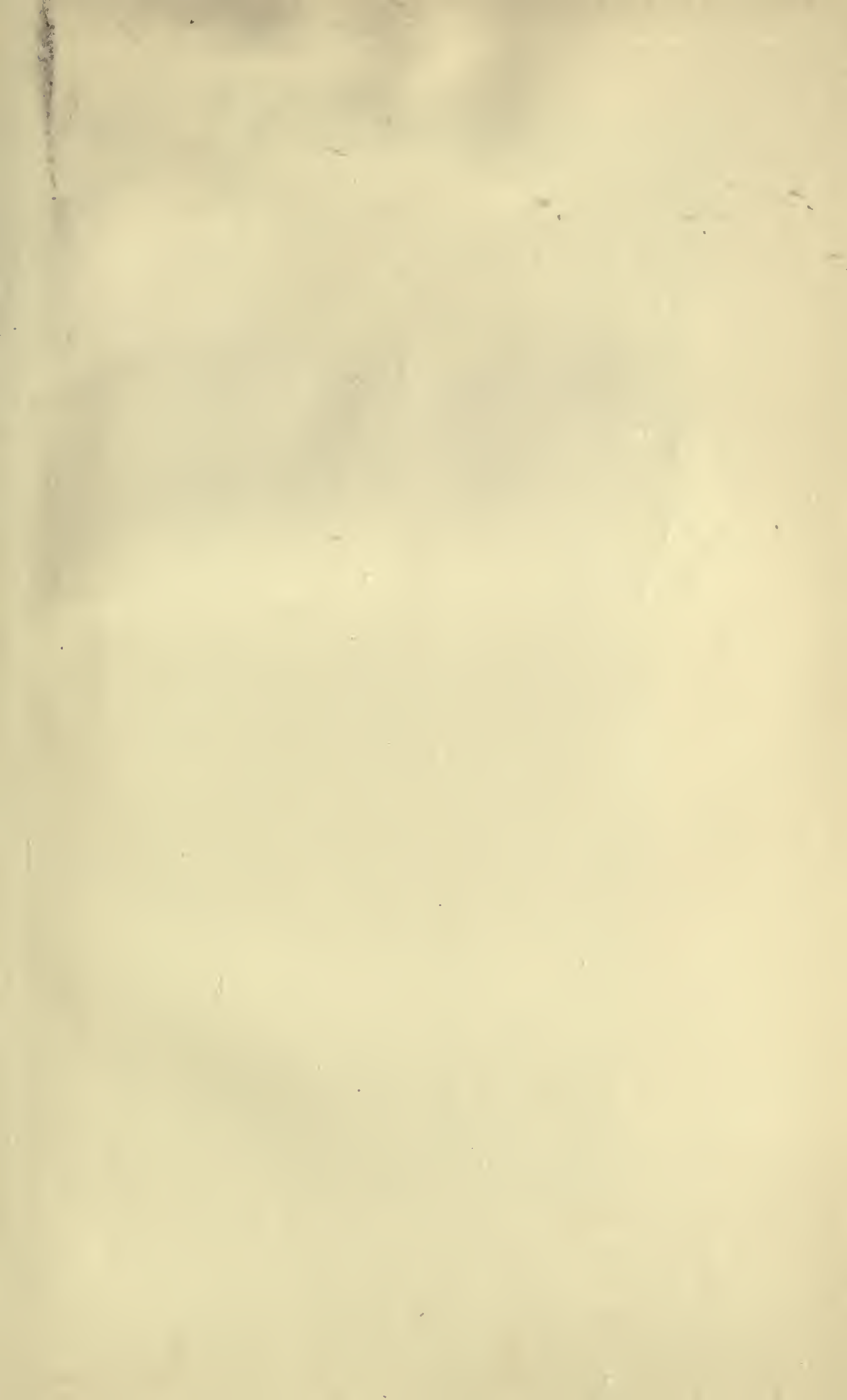

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